

# William Michael Cunningham

Economist and Social Investing Advisor

May 24, 2015

Luisa Grillo-Chope and Fred Wong, Office of Regulations and Interpretations  
Karen Lloyd, Office of Exemption Determinations  
Christopher Cosby, Office of Policy and Research  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue NW.  
Washington, DC 20210

Via Email: e-ORI@dol.gov

Re: RIN 1210-AB32

Ladies and Gentlemen:

We understand that “the Department (of Labor) is proposing new exemptions and amendments to existing exemptions from the prohibited transaction rules applicable to fiduciaries under ERISA and the Code that would allow certain broker-dealers, insurance agents and others that act as investment advice fiduciaries to continue to receive a variety of common forms of compensation that otherwise would be prohibited as conflicts of interest.”

I believe I have expertise borne of education and experience that may be helpful<sup>1</sup>. Further, we respectfully remind the Department that “*All men are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly, affects all indirectly.*” This is certainly true with respect to the subject matter at issue here.

## **Background**

In order to place this matter in the proper context, we refer the Department to the following facts:

- April 28, 2003, every major US investment bank, including Merrill Lynch, Goldman Sachs, Morgan Stanley, Citigroup, Credit Suisse First Boston, Lehman Brothers Holdings, J.P. Morgan Chase, UBS Warburg, and U.S. Bancorp Piper Jaffray, were found to have aided and abetted efforts to defraud investors.

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<sup>1</sup> I include all linked documents herein by reference in their entirety.

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- May, 2003, the Securities and Exchange Commission (“SEC”) disclosed that several “brokerage firms paid rivals that agreed to publish positive reports on companies whose shares..they issued to the public.”
- September 3, 2003, the New York State Attorney General “obtained evidence of widespread illegal trading schemes, ‘late trading’ and ‘market timing,’ that potentially cost mutual fund shareholders billions of dollars annually.”
- September 4, 2003, Goldman Sachs, admitted that it had misused material, nonpublic information that the US Treasury would suspend issuance of the 30-year bond.
- December 18, 2003, the SEC “announced an enforcement action against Alliance Capital Management L.P. (Alliance Capital) for defrauding mutual fund investors.. the Commission found that Alliance Capital breached its fiduciary duty to (it’s) funds and misled those who invested in them.”
- October 8, 2004, the SEC “announced..enforcement actions against Invesco Funds Group, Inc. (IFG), AIM Advisors, Inc. (AIM Advisors), and AIM Distributors, Inc. (ADI) that required IFG to pay \$215 million in disgorgement and \$110 million in civil penalties, and require AIM Advisors and ADI to pay, jointly and severally, \$20 million in disgorgement and an aggregate \$30 million in civil penalties.”
- November 4, 2004, the SEC “filed a settled civil action in the US District Court for the District of Columbia against Wachovia Corporation. Wachovia paid a \$37 million penalty.”
- November 17, 2004, the SEC announced “charges concerning undisclosed market timing against Harold J. Baxter and Gary L. Pilgrim in the Commissions’ pending action in federal district court in Philadelphia.” Baxter and Pilgrim agreed to “pay \$80 million – \$60 million in disgorgement and \$20 million in civil penalties.”
- November 30, 2004, the SEC announced “American International Group, Inc. (AIG) agreed to pay a total of \$126 million, consisting of a penalty of \$80 million, and disgorgement and prejudgment interest of \$46 million.”
- December 22, 2004, “the SEC, NASD and the New York Stock Exchange announced Edward D. Jones & Co., L.P., a registered broker-dealer in St. Louis, Missouri.. agreed to pay \$75 million in disgorgement and civil penalties.”
- January 25, 2005, “the SEC announced separate settled civil injunctive actions against Morgan Stanley & Co. Incorporated (Morgan Stanley) and Goldman, Sachs & Co. (Goldman Sachs) relating to the firms’ allocations of stock to institutional customers in initial public offerings (IPOs) underwritten by the firms during 1999 and 2000.”
- January 31, 2005, “the nation’s largest insurance brokerage company, Marsh & McLennan Companies Inc., (paid) \$850 million to policyholders and issues a public apology calling its conduct “unlawful” and “shameful..”
- February 9, 2005, the SEC “announced the settlement of an enforcement action against Columbia Management Advisors, Inc. (Columbia Advisors), Columbia Funds Distributor, Inc. (Columbia Distributor), and three former Columbia executives. Columbia paid \$140 million.”
- March 23, 2005, the SEC “announced Putnam Investment Management, LLC (Putnam) will pay \$40 million for failing to adequately disclose conflicts of interest.”

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- March 23, 2005, the SEC “announced that it settled an enforcement action against Citigroup Global Markets, Inc. (CGMI).”
- April 19, 2005, the SEC “announced that KPMG LLP settled charges against it in connection with the audits of Xerox Corp. from 1997 through 2000.” KPMG paid a fine totaling \$22.475 million.
- April 12, 2005, the SEC “settled an enforcement action against the New York Stock Exchange, Inc.”
- April 28, 2005, the SEC announced “that it has instituted settled enforcement proceedings against Tyson Foods, Inc. and its former Chairman and CEO Donald "Don" Tyson.
- May 31, 2005, the SEC “announced settled fraud charges against two subsidiaries of Citigroup, Inc. Citigroup paid \$208 million in disgorgement and penalties.”
- June 2, 2005, the SEC “filed securities fraud charges against Amerindo Investment Advisors, Inc., et. al., for misappropriating at least \$5 million from an Amerindo client.”
- June 9, 2005, the SEC announced that “Roys Poyiadjis, a former CEO of AremisSoft Corporation, consented to disgorge approximately \$200 million of unlawful profit from his trading in AremisSoft stock.”
- July 20, 2005, the SEC “announced a settled administrative proceeding against Canadian Imperial Bank of Commerce's (CIBC) for..facilitating deceptive market timing and late trading of mutual funds by certain customers. The firm paid \$125 million in disgorgement and penalties.”
- August 15, 2005, the SEC “charged four brokers and a day trader with cheating investors through a fraudulent scheme that used squawk boxes to eavesdrop on the confidential order flow of major brokerages.”
- August 22, 2005, the SEC “filed civil fraud charges against two former officers of Bristol-Myers Squibb Company for orchestrating a fraudulent earnings management scheme.”
- August 23, 2005, the SEC “filed charges against two former top Kmart executives for misleading investors.”
- November 2, 2005, the SEC “filed enforcement actions against seven individuals alleging they aided and abetted a massive financial fraud at U.S. Foodservice, Inc. subsidiary of Royal Ahold (Koninklijke Ahold N.V.).”
- November 28, 2005, the SEC announced “that three affiliates of one of the country’s largest mutual fund managers..agreed to pay \$72 million to settle charges they harmed long-term mutual fund shareholders.”
- December 1, 2005, the SEC “announced settled enforcement proceedings against American Express Financial Advisors Inc. AEFA paid \$30 million in disgorgement and civil penalties.”
- December 1, 2005, the SEC “announced a settled administrative proceeding against Millennium Partners, L.P., et. al., The respondents paid \$180 million in disgorgement and penalties.”
- December 19, 2005, the SEC “announced that it filed and settled insider trading charges both against an accountant and a former executive of Sirius Satellite Radio, Inc.”
- On December 21, 2005, the SEC “sued top executives of National Century Financial Enterprises, Inc. (NCFE), alleging that they participated in a scheme to defraud investors. NCFE suddenly collapsed in

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October 2002, causing investor losses exceeding \$2.6 billion and approximately 275 health-care providers were forced to file for bankruptcy protection.”

- January 3, 2006, the SEC announced “that it filed charges against six former officers of Putnam Fiduciary Trust Company (PFTC).”
- January 4, 2006, the SEC “filed securities fraud charges against McAfee, Inc. McAfee paid a \$50 million civil penalty.”
- January 9, 2006, the SEC “announced that Daniel Calugar and Security Brokerage, Inc. (SBI), agreed to settle the SEC’s charges. Calugar disgorged \$103 million in ill-gotten gains and paid a civil penalty of \$50 million.”
- February 2, 2006, the SEC “announced that it filed an enforcement action against five former senior executives of General Re Corporation (Gen Re) and American International Group, Inc. (AIG) for helping AIG mislead investors.”
- February 9, 2006, the SEC announced “the settlement of charges that American International Group, Inc. (AIG) committed securities fraud. AIG paid in \$1.6 billion to resolve claims related to improper accounting, bid rigging and practices involving workers’ compensation funds.”
- March 9, 2006, the SEC filed a lawsuit “against BMA Ventures, Inc. and its president, William Robert Kepler, 35, of Dallas, Texas, alleging that they illegally obtained approximately \$1.9 million in a fraudulent scheme from January 2004 through March 2005.
- On March 16, 2006, the SEC “announced a settled enforcement action against Bear, Stearns & Co., Inc. (BS&Co.) and Bear, Stearns Securities Corp. (BSSC). Bear Stearns paid \$250 million in disgorgement penalties.”
- April 11, 2006, the SEC announced “charges against individuals involved in widespread and brazen international schemes of serial insider trading. The schemes were orchestrated by..a research analyst in the Fixed Income division of Goldman Sachs.”
- April 17, 2006, the SEC brought “Settled Charges Against Tyco International Ltd. Alleging (a) Billion Dollar Accounting Fraud.”
- May 10, 2006, the SEC ordered “Former Chairman and CEO of Gemstar-TV Guide International, Inc. .. to Pay Over \$22 Million For Role in Accounting Fraud.”
- May 10, 2006, the SEC sued “Morgan Stanley.”
- “May 23, 2006, the (SEC) filed a settled enforcement proceeding against the Federal National Mortgage Association (‘Fannie Mae’).”
- May 30, 2006, the SEC brought “Settled Charges Against Tribune Company for Reporting Inflated Circulation Figures and Misstating Circulation Revenues.”
- May 31, 2006, Bear, Stearns & Co. Inc.; Citigroup Global Markets, Inc.; Goldman, Sachs & Co.; J.P. Morgan Securities, Inc.; Lehman Brothers Inc.; Merrill Lynch, Pierce, Fenner & Smith Incorporated; Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc.; RBC Dain Rauscher Inc.; Banc of America Securities LLC; A.G. Edwards & Sons, Inc.; Morgan Keegan & Company, Inc.; Piper Jaffray & Co.; Suntrust Capital Markets inc.; and Wachovia Capital Markets, LLC, settled “SEC Charges Involving Violative Practices in the Auction Rate Securities Market.”

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- June 27, 2006, the SEC charged “Morgan Stanley With Failure To Maintain And Enforce Policies To Prevent Misuse of Inside Information.”
- June 28, 2006, the SEC settled with “Raytheon Company, it’s former CEO, and Subsidiary Controller for Improper Disclosure and Accounting Practices.”
- June 30, 2006, a jury found “Former PIMCO Equity Funds Chairman Defrauded Investors in Market Timing Case.”
- August 7, 2006, “Martha Stewart and Peter Bacanovic Settle(d) SEC's Insider Trading Charges.”
- August 28, 2006, Prudential Securities Inc. (APSI) was ordered “to Pay \$600 Million in Global Settlement of Fraud Charges...”
- September 27, 2006, the SEC charged “Former CEO and Two Former Executives Affiliated with RenaissanceRe Holdings Ltd. with Securities Fraud.”
- October 30, 2006, the SEC charged “Delphi Corporation and Nine Individuals in wide-ranging financial fraud.”
- November 2, 2006, the SEC settled “Charges against Eight Former Officers and Directors of Spiegel, Inc.”
- November 14, 2006, the SEC sanctioned “the City Of San Diego for Fraudulent Municipal Bond Offerings and Order(ed) the City to Retain an Independent Consultant.”
- December 4, 2006, “Jefferies & Co., Inc. (Jefferies) Settle(d) SEC Charges.”
- January 18, 2007, “Fred Alger Management and Fred Alger & Company (agreed) to Pay \$40 Million to Settle Market Timing and Late Trading Violations.”
- January 29, 2007, “MBIA Settle(d) Securities Fraud Charges for Misuse of Reinsurance Contracts.”
- March 1, 2007, “The SEC announced insider trading charges against fourteen defendants in connection with two..insider trading schemes.”
- March 12, 2007, the SEC charged “Four Former Senior Executives of Nortel Networks Corporation in Wide-Ranging Financial Fraud Scheme.”
- March 14, 2007, the SEC and the NYSE settled “Enforcement Actions Against (a) Goldman Sachs Unit for Role in Customers' Illegal Trading Scheme.”
- March 14, 2007, the SEC brought an enforcement action “Against Banc of America Securities for Failing to Safeguard Nonpublic Research Information and Publishing Fraudulent Research.” The firm agreed to pay \$26 Million.
- March 15, 2007, the SEC settled “With Former Raytheon Officers For Improper Disclosure and Accounting Practices.”
- March 15, 2007, the SEC announced a “\$28.7 Million Settlement of Fraud Charges against F. David Radler, Former COO of Hollinger International, Inc.”
- March 22, 2007, the SEC charged “American Stock Exchange and Former Chairman and CEO Salvatore Sodano with Failing to Exercise Regulatory Oversight Responsibilities.”
- March 29, 2007, Nicor paid “\$10 Million to Settle Fraud Charges.”

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- April 2, 2007, the SEC charged “Tenet Healthcare Corporation and Four Former Senior Executives With Concealing Scheme to Meet Earnings Targets by Exploiting Medicare System.”
- April 24, 2007, the SEC charged the “Former Apple General Counsel for Illegal Stock Option Backdating.”
- April 26, 2007, the SEC charged “Baker Hughes With Foreign Bribery and With Violating 2001 Commission Cease-and-Desist Order.”
- May 9, 2007, “Morgan Stanley (agreed) to Pay \$7.9 Million to Settle Best Execution Case.”
- May 14, 2007, the SEC charged “Former Oracle Vice President with Illegal Insider Trading in Stocks of Oracle Acquisition Targets.”
- “May 23, 2007, the SEC filed a civil injunctive action in US District Court for the Southern District of New York charging the BISYS Group, Inc. with violating the financial reporting, books-and-records, and internal control provisions of the Securities Exchange Act of 1934. BISYS paid \$25 million in disgorgement and interest.”
- May 31, 2007, “The SEC..filed civil fraud charges against Mercury Interactive, LLC and four former senior officers of Mercury. The SEC alleges that the former senior officers perpetrated a fraudulent and deceptive scheme from 1997 to 2005 to award themselves and other employees undisclosed, secret compensation by backdating stock option grants and failing to record hundreds of millions of dollars of compensation expense.”
- July 25, 2007, “The SEC..filed civil charges against ConAgra Foods, Inc. for fraudulent, accounting practices.”
- July 26, 2007, “The SEC..filed a civil action against Cardinal Health, Inc. Cardinal agreed to pay \$35 million.”
- September 5, 2007, the SEC charged “26 Defendants in \$428 Million Securities Fraud That Targeted Senior Citizens and Retirement Savings.”
- September 19, 2007, “Evergreen Investment Management Company and Affiliates (agreed) to Pay \$32.5 Million to Settle Market Timing Violations.”
- September 19, 2007, “HSBC Bank Settle(d) SEC Charges and Agree(d) to Pay \$10.5 Million.”
- “September 20, 2007, the SEC filed a civil injunctive action charging 28 defendants in a series of fraudulent schemes.”
- “September 27, 2007, the SEC filed a settled enforcement action charging the Federal Home Loan Mortgage Corporation (‘Freddie Mac’).”
- October 25, 2007, “the SEC.. announced the filing of securities fraud charges against David H. Brooks, the former Chief Executive Officer and Chairman of the Board at DHB Industries, Inc., charging that Brooks engaged in a pervasive accounting fraud at DHB between 2003 and 2005, violated insider trading laws in 2004, and used millions of dollars in corporate funds to pay personal expenses.”
- November 14, 2007, “the SEC.. filed Foreign Corrupt Practices Act books and records and internal controls charges against Chevron Corporation (‘Chevron’).”
- February 5, 2008, “the SEC..announced settled insider trading charges against four Hong Kong residents for illegal tipping and trading in the securities of Dow Jones & Company, Inc. (‘Dow Jones’).

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The alleged tip originated with David Li Kwok Po ('David Li'), who served on the Dow Jones board of directors."

- May 1, 2008, "The Securities and Exchange Commission..filed a civil injunctive action against McCann-Erickson Worldwide, Inc. ('McCann') and the Interpublic Group of Companies, Inc. ('IPG')."
- May 1, 2008, the SEC charged "Banc of America Investment Services With Failing to Disclose It Favored Affiliated Mutual Funds."
- July 30, 2008, "The Securities and Exchange Commission..charged New Hampshire-based Pax World Management Corp. with violating investment restrictions."
- August 11, 2008, "The Securities and Exchange Commission..filed charges against Wextrust Capital, LLC (Wextrust), its principals, and four affiliated Wextrust entities, alleging that defendants conducted a massive Ponzi-type scheme from 2005 or earlier that raised approximately \$255 million from approximately 1,200 investors. The targets of the fraudulent offerings are primarily members of the Orthodox Jewish community."
- September 3, 2008, the "Securities and Exchange Commission..charged two Wall Street brokers (at Credit Suisse Securities (USA) LLC) with defrauding their customers when making more than \$1 billion in unauthorized purchases of subprime-related auction rate securities."
- September 3, 2008, The "SEC charged former Kellogg, Brown & Root, Inc. (KBR) executive Albert Jackson Stanley with violating the anti-bribery provisions of the Foreign Corrupt Practices Act (FCPA).."
- September 14, 2008, the SEC "announced..that, together with the Treasury and the Federal Reserve, it is working with Lehman Brothers to address the issues that it faces."
- September 15, 2008, the SEC "charged the former chairman and CEO of ..KB Home, Inc., for his participation in a multi-year scheme to backdate stock options to himself and other company officers and employees, depriving investors of accurate information about executive compensation at the company."
- October 7, 2008, the "SEC..charged a former vice president at..Restoration Hardware with insider trading."
- November 18, 2008, the SEC "charged four individuals for engaging in a fraudulent scheme to overvalue the commodity derivatives trading portfolio at Bank of Montreal (BMO)."
- December 11, 2008, the SEC "finalized settlements with Citigroup Global Markets, Inc. (Citi) and UBS Securities LLC and UBS Financial Services, Inc. (UBS) that will provide nearly \$30 billion to tens of thousands of customers."
- December 11, 2008, the SEC "charged Bernard L. Madoff and his investment firm, Bernard L. Madoff Investment Securities LLC, with securities fraud."
- December 18, 2008, the SEC "charged seven individuals and two companies involved in an insider trading ring, alleging that Matthew Devlin, at Lehman Brothers, Inc. in NY,, traded on confidential information."
- December 22, 2008, the SEC "filed a civil injunctive action against UnitedHealth Group Inc., alleging that it engaged in a scheme to backdate stock \$1 billion in options."

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- February 5, 2009, the SEC “charged seven individuals involved in an insider trading ring that generated more than \$11.6 million in illegal profits and avoided losses.
- The SEC allege(d) that two mergers and acquisitions professionals, at UBS Investment Bank and at Blackstone Advisory Services, L.P., tipped five individuals with material nonpublic information about three impending corporate acquisitions.”
- February 5, 2009, the SEC “filed an enforcement action against UBS AG, charging the firm with acting as an unregistered broker-dealer and investment adviser.”
- February 17, 2009, the SEC “charged Robert Allen Stanford with orchestrating a fraudulent, multi-billion dollar investment scheme.”
- March 2, 2009, the SEC “charged Sunwest Management Inc. with securities fraud.”
- February 25, 2009, the SEC “obtained an asset freeze against two New York residents and their three affiliated entities, who orchestrated a brazen investment fraud involving the misappropriation of as much as \$554 million in investor assets.”
- March 4, 2009, the SEC “brought enforcement actions against 14 specialist firms for unlawful proprietary trading on several regional and options exchanges.” • March 11, 2009, the SEC “charged Merrill Lynch, Pierce, Fenner & Smith Inc. with securities laws violations.”
- May 12, 2009, the SEC “charged Julio Ramirez, Jr., in connection with a multi-million dollar kickback scheme involving New York's largest pension fund.”
- June 24, 2009, the SEC “charged a money manager.. in Wayland, Mass., for conducting a multi-million dollar Ponzi scheme.”
- July 22, 2009, the SEC “asked a court to order the former chief executive officer of CSK Auto Corporation to reimburse the company and its shareholders more than \$4 million that he received in bonuses and stock sale profits while CSK was committing accounting fraud.”
- July 28, 2009, the SEC “obtained a court order to halt an alleged offering fraud and Ponzi scheme being conducted in the Detroit area by two individuals and two companies they control.”
- August 3, 2009, the SEC “charged Bank of America Corporation for misleading investors about billions of dollars in bonuses that were being paid to Merrill Lynch & Co. executives at the time of its acquisition of the firm.”
- September 28, 2009, the SEC “charged (a) Detroit-area stock broker..with fraud, alleging that he lured elderly investors into a \$250 million Ponzi scheme.”
- October 16, 2009 — the SEC “charged billionaire Raj Rajaratnam and his New York-based hedge fund advisory firm Galleon Management LP with engaging in a massive insider trading scheme.”
- November 4, 2009, the SEC “charged J.P. Morgan Securities Inc. and two of its former managing directors for their roles in an unlawful payment scheme.”
- November 4, 2009, the SEC “charged Milwaukee-based Merge Healthcare Incorporated and two former senior executives for their roles in an accounting fraud.”
- November 4, 2009, the SEC “charged New York City-based investment adviser Value Line Inc., its CEO, its former Chief Compliance Officer and its affiliated broker-dealer with defrauding the Value Line family of mutual funds.”

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- November 5, 2009, the SEC “charged a pair of lawyers for tipping inside information in exchange for kickbacks.”
- November 16, 2009, the SEC “charged four individuals and two companies involved in perpetrating a \$30 million Ponzi scheme.”
- December 7, 2009, the SEC “charged three former top officers of New Century Financial Corporation with securities fraud for misleading investors as New Century's subprime mortgage business was collapsing in 2006.”
- January 5, 2010, the SEC “announced that a former Perot family companies employee it charged with insider trading in September has agreed to return all of his illicit profits — a total of more than \$8.6 million.”
- January 20, 2010, the SEC “charged General Re Corporation for its involvement in separate schemes by American International Group (AIG) and Prudential Financial, Inc. to manipulate and falsify their reported financial results.”
- On February 4, 2010, the SEC “charged Boston-based State Street Bank and Trust Company with misleading its investors about their exposure to subprime investments while selectively disclosing more complete information to specific investors.”
- On March 4, 2010, the SEC “charged a self-proclaimed psychic who fraudulently raised \$6 million after telling investors he could predict stock market highs and lows.”
- On March 5, 2010, the SEC “charged a San Diego-based broker-dealer with failing to reasonably supervise one of its registered representatives who engaged in unauthorized fraudulent trading in the accounts of two Florida municipalities.”
- On March 24, 2010, the SEC “filed fraud charges against a prominent New Mexico realtor and obtained an emergency court order to halt his \$80 million Ponzi scheme.”
- On March 29, 2010, the SEC “charged an Ohio-based investment adviser with fraud for lying about his investment strategy, fabricating account statements to hide losses, and using investor money to buy property and pay unrelated business expenses.”
- On April 1, 2010, the SEC “announced a settlement with Daimler AG for violations of the Foreign Corrupt Practices Act (FCPA), alleging that the..automobile manufacturer engaged in a repeated and systematic practice of paying bribes to foreign government officials to secure business in Asia, Africa, Eastern Europe and the Middle East.”
- On April 7, 2010, the SEC charged “Morgan Keegan and Two Employees With Fraud Related to Subprime Mortgages.”
- On April 15, 2010, the SEC “charged a private investment firm and one of its affiliated entities for participating in a widespread kickback scheme to obtain investments from New York's largest pension fund.”
- On April 16, 2010, the SEC “charged Goldman, Sachs & Co. and one of its vice presidents for defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the U.S. housing market was beginning to falter.”

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- On April 22, 2010, the SEC “charged a private equity firm, a money manager and his friend with participating in a fraudulent scheme through which they stole more than \$3 million invested by three Detroit-area public pension funds.”
- On May 7, 2010, the California's attorney general announced a lawsuit targeting “two former officials from Calpers, the nation's largest public pension fund, alleging that they took kickbacks in exchange for a piece of the fund's lucrative investment portfolio.”
- On June 16, 2010, the SEC “charged the former chairman and majority owner of what was once the nation's largest non-depository mortgage lender with orchestrating a large-scale securities fraud scheme and attempting to scam the U.S. Treasury's Troubled Asset Relief Program (TARP).”
- On June 21, 2010, the SEC “charged a New York-based investment adviser and three of his affiliated firms with fraudulently managing investment products tied to the mortgage markets as they came under pressure in 2007.”
- On July 15, 2010, the SEC “announced that Goldman, Sachs & Co. will pay \$550 million and reform its business practices to settle SEC charges that Goldman misled investors in a subprime mortgage product just as the U.S. housing market was starting to collapse.”
- On July 22, 2010, the SEC “charged Dell Inc. with failing to disclose material information to investors and using fraudulent accounting to make it falsely appear that the company was consistently meeting Wall Street earnings targets and reducing its operating expenses. Dell Inc. agreed to pay a \$100 million penalty to settle the SEC's charges.”
- On July 29, 2010, the SEC “charged Citigroup Inc. with misleading investors about the company's exposure to subprime mortgage-related assets.”
- On August 4, 2010, the SEC “charged a former Deloitte and Touche LLP partner and his son with insider trading in the securities of several of the firm's audit clients.”
- On August 6, 2010, the SEC “charged two global tobacco companies with violations of the Foreign Corrupt Practices Act (FCPA) for paying more than \$5 million in bribes to government officials in Thailand and other countries to illicitly obtain tobacco sales contracts.”
- On August 18, 2010, the SEC “charged the State of New Jersey with securities fraud for misrepresenting and failing to disclose to investors in billions of dollars worth of municipal bond offerings that it was underfunding the state's two largest pension plans.”
- On September 29, 2010, the SEC “charged ABB Ltd with violations of the Foreign Corrupt Practices Act (FCPA) for using subsidiaries to pay bribes to Mexican officials to obtain business with government-owned power companies, and to pay kickbacks to Iraq to obtain contracts under the U.N. Oil for Food Program.”
- On October 15, 2010, the SEC “announced that former Countrywide Financial CEO Angelo Mozilo will pay a record \$22.5 million penalty to settle SEC charges that he and two other former Countrywide executives misled investors as the subprime mortgage crisis emerged.”
- On November 4, 2010, the SEC “announced sweeping settlements with global freight forwarding company Panalpina, Inc., Pride International, Inc., Tidewater Inc., Transocean, Inc., GlobalSantaFe Corp., and Noble Corporation, all companies in the oil services industry who, according to the SEC, violated the

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Foreign Corrupt Practices Act (FCPA) by paying millions of dollars in bribes to foreign officials to receive preferential treatment and improper benefits during the customs process.”

- On December 27, 2010, the SEC “charged Paris-based telecommunications company Alcatel-Lucent, S.A. with violating the Foreign Corrupt Practices Act (FCPA) by paying bribes to foreign government officials to illicitly win business in Latin America and Asia.”
- On January 25, 2011, the SEC “charged Merrill Lynch, Pierce, Fenner & Smith Incorporated with securities fraud for misusing customer order information to place proprietary trades for the firm and for charging customers undisclosed trading fees. To settle the SEC's charges, Merrill..agreed to pay a \$10 million penalty and consent to a cease-and-desist order.”
- On February 3, 2011, the SEC “charged three AXA Rosenberg entities with securities fraud for concealing a significant error in the computer code of the quantitative investment model that they use to manage client assets. The error caused \$217 million in investor losses.”
- On March 1, 2011, the SEC “announced insider trading charges against a business consultant who has served on the boards of directors at Goldman Sachs and Procter & Gamble for illegally tipping Galleon Management founder and hedge fund manager Raj Rajaratnam with inside information about the quarterly earnings at both firms as well as an impending \$5 billion investment by Berkshire Hathaway in Goldman.”
- On April 6, 2011, the SEC “charged a corporate attorney and a Wall Street trader with insider trading in advance of at least 11 merger and acquisition announcements involving clients of the law firm where the attorney worked.”
- On June 21, 2011, the SEC “announced that J.P. Morgan Securities LLC will pay \$153.6 million to settle SEC charges that it misled investors in a complex mortgage securities transaction just as the housing market was starting to plummet.”
- On June 22, 2011, the Securities and Exchange Commission, state regulators, and the Financial Industry Regulatory Authority (FINRA) announced..that Morgan Keegan & Company and Morgan Asset Management have agreed to pay \$200 million to settle fraud charges related to subprime mortgage-backed securities.”

*In no section of the proposed regulation does the Department acknowledge these facts.* This is akin to designing rules governing the construction of residential and office building firewalls without acknowledging that the goal of the rules are to limit damage done by fire.

Further, we note that the Department seeks, via the proposed regulation, to “enable advisers and their firms to give advice that is in the best interest of their customers, without disrupting common compensation arrangements under conditions designed to ensure the adviser is acting in the best interest of the advice recipient.”

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The Department fails to recognize that *it is these common compensation arrangements* that give rise to the behavior, outlined above, that is contrary to the best interest of both investors and the general public.

In light of the track record above, this regulatory goal is simply inappropriate and inconsistent. This places the Department in the position of wanting “*crops without ploughing the ground; they want rain without thunder and lightning; they want the ocean without the roar of its many waters.*”<sup>2</sup> We remind the Department that the current set of dominant financial institutions will “*concede nothing without a demand*” and the proposed regulation appears to be without a request or demand in the public interest.

The economic crisis of 2006 to 2013 resulted in the loss of millions of jobs, cost thousands of lives<sup>3</sup> and imposed trillions of dollars in actual and potential losses. The downturn was entirely predictable.<sup>4</sup>

The public remains at risk

The following are the simple facts. Repeatedly over the past thirty years, signal market participants, operating in the most materially advantaged country ever to exist, abandoned ethical principles in the pursuit of material wellbeing. By 2013, marketplace ethics, as evidenced above, reached a new low. Senior management at major firms unfairly transferred value from outsider to insider shareholders and/or engaged in fraudulent and unethical business behavior.

This is no trivial matter. This is a multi-decade set of unethical business practices spanning every major firm in the country. There are hundreds of other cases.<sup>5</sup> Envy, hatred, and greed<sup>6</sup> have flourished in capital market institutions, propelling ethical standards of behavior downward. Thus, unethical behavior

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<sup>2</sup> Douglass, Frederick. [1857] (1985). "The Significance of Emancipation in the West Indies." Speech, Canandaigua, New York, August 3, 1857; collected in pamphlet by author. In *The Frederick Douglass Papers. Series One: Speeches, Debates, and Interviews. Volume 3: 1855-63.* Edited by John W. Blassingame. New Haven: Yale University Press, p. 204.

<sup>3</sup> “Just as the commandment ‘Thou shalt not kill’ sets a clear limit in order to safeguard the value of human life, today we also have to say ‘thou shalt not’ to an economy of exclusion and inequality. Such an economy kills.” Pope Francis. *EVANGELII GAUDIUM*. Page 45. November 24, 2013.

<sup>4</sup> Supreme Court of the United States. No. 97–5066. William Michael Cunningham, Petitioner v. Board of Governors of the Federal Reserve System. Petition for writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit.

<sup>5</sup> For each successfully prosecuted incident, we estimate nine others either go undetected or do not make it to the prosecution and settlement phase.

<sup>6</sup> See: Transaction Cost Theory of the Crisis <http://www.prlog.org/10746429-firm-releases-transaction-cost-theory-of-the-financial-crisis.html>.

<sup>6</sup> “Bank accused of predatory practices. Lawsuit alleges black neighborhood, churches targeted.” *Gazette.net*. Online at: [http://www.gazette.net/stories/06182009/collnew182411\\_32521.shtml](http://www.gazette.net/stories/06182009/collnew182411_32521.shtml)

<sup>6</sup> The relationship between investment banks and the economy. <http://twisri.blogspot.com/2009/04/commercial-and-investment-banks-used.html> and <http://twisri.blogspot.com/2009/03/why-market-failed.html>

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[www.creativeinvest.com](http://www.creativeinvest.com)

# William Michael Cunningham

Economist and Social Investing Advisor

May 24, 2015

has become standard in the financial services marketplace,<sup>7</sup> to the benefit of a narrow set of non-minority individuals. Markets cannot survive continuously elevated levels of fraud, since fraudulent practices mask an entity's true value and misallocates capital by moving investment dollars from deserving entities and companies to unworthy ones. Without meaningful reform, there remains a significant and growing risk that our economic system will simply cease functioning.<sup>8</sup> Given this, the future of American democratic capitalism is at stake.

## Background

William Michael Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services.

Creative Investment Research, Incorporated is an independent investment research and management firm, founded in 1989. For clients, our services save millions, if not billions: on December 22, 2003 and February 6, 2006, we warned the S.E.C. and other regulators that statistical models using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure (see below). Clients who heeded our warning adjusted their investment portfolios in a manner that allowed them to escape much of the damage caused by the crisis. The firm was formerly in the pool of Corporate Governance Advisors and Diversity Investing Advisors to CalPERS.

Mr. Cunningham is a Global Member of the Internet Society (ISOC), a Public Member of the World Wide Web Consortium (W3C), and an Invited Expert Member in the eGovernment Group of the W3C. On November 16, 1995, he launched one of the first investment advisor websites at [www.ari.net/cirm](http://www.ari.net/cirm) (now [www.creativeinvest.com](http://www.creativeinvest.com)).

## Track Record

On July 3, 1993, Mr. Cunningham wrote to US Securities and Exchange Commissioner (SEC) Mary Schapiro to notify the Commission about a specific investing scam, the "Nigerian letter scam." A timely warning was not issued to the investing public, members of the public were damaged, and the SEC launched retaliatory regulatory actions *against* Mr. Cunningham.

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<sup>7</sup> These "ideologies which defend the absolute autonomy of the marketplace and financial speculation...reject the right of states, charged with vigilance for the common good, to exercise any form of control. A new tyranny is thus born, invisible and often virtual, which unilaterally and relentlessly imposes its own laws and rules." FRANCIS, Apostolic Exhortation Evangelii Gaudium (26 November 2013)

<sup>8</sup> Proportional hazard models created by WMC and reflecting the probability of system wide market failure first spiked in September, 1998. The models spiked again in January and August, 2001. On December 22, 2005, we met with Ms. Elaine M. Hartmann and others from the Division of Market Regulation, U.S. Securities and Exchange Commission and specifically detailed our model findings.

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He designed the first mortgage security backed by home mortgage loans to low and moderate income persons and originated by minority-owned institutions. (See: [Security Backed Exclusively by Minority Loans](#), *The American Banker Newspaper*. Friday, December 2, 1994.)

Mr. Cunningham opposed the application, approved by the Federal Reserve Board on September 23, 1998, by Travelers Group Inc., New York, New York, to become a bank holding company (<http://www.creativeinvest.com/FRBtrav.pdf>). In October 1998, in a petition to the United States Court of Appeals (Case Number 98-1459) concerning the Travelers Group Inc./Citicorp merger (<http://www.creativeinvest.com/USAppealsCourt.pdf>), Mr. Cunningham cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions.

From October 1999 to March 2002, Mr. Cunningham was responsible for proxy voting activity for the Board of Pensions of the Evangelical Lutheran Church in America. In 2001, he voted on 1,395 issues impacting 401 companies. In 2000, he voted on 1,903 issues impacting 422 companies. He managed fund efforts and corporate governance matters related to Talisman Energy and its' operations in the Sudan. He researched the issue, contacting various groups involved in the process. Our efforts also included researching fund policies and procedures. His collaborative, risk controlled strategy helped lead the firm out of the Sudan. On February 1, 2000, Mr. Cunningham wrote to the office of U.S. Senator Samuel Brownback (<http://www.creativeinvest.com/SudanSenateLtr.pdf>) urging him to encourage pension funds to divest from the Sudan.

On June 15, 2000, Mr. Cunningham testified before the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE) of the U.S. House of Representatives and suggested that GSE Fannie Mae and Freddie Mac be subject to a *Social Audit*. A social audit is an examination of the performance of an enterprise relative to certain social return objectives. It includes a review of ethical practices. Had the GSE been subject to this audit, certain flaws in their operation, including ethical shortcomings, would have been revealed earlier, **prior to the GSEs entering bankruptcy**. (See: <http://www.creativeinvest.com/fnma/fnmapr16.html>)

In 2001, Mr. Cunningham participated in the first wide scale home mortgage loan modification project. The Minneapolis-based effort helped 50 families victimized by predatory lending practices. See: Property Flipping Remediation Yields Investment-grade Security. (<http://www.socialfunds.com/news/article.cgi/article682.html>)

On December 22, 2003, we warned US regulators that statistical models created by the firm using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure See Page 6. (<http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf>)

In 2005, Mr. Cunningham served as an expert witness in a case that sought to hold Credit Suisse First Boston, Fairbanks/SPS, Moody's and Standard and Poor's, US National Bank Association, and other

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parties legally responsible for supporting and facilitating fraudulent subprime lending market activities.

***Had this single case been successful, we believe the credit crisis would have been less severe.***

On December 22, 2005, he issued a strongly worded warning that system-wide economic and market failure was a growing possibility in a meeting at the SEC with Ms. Elaine M. Hartmann of the Division of Market Regulation.

On February 6, 2006, we again warned regulators that statistical models we created using the proprietary Fully Adjusted Return® Methodology confirmed that system-wide economic and market failure was a growing possibility. We stated that: *Without meaningful reform there is a small, but significant and growing, risk that our (market) system will simply cease functioning.* This is, of course, exactly what happened. See pages 2 and 8.

<http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf>

We created the first consistent methodology for measuring the social impact of banking activities, which we discussed on August 3, 2006 at a seminar sponsored by Fannie Mae and the Federal Reserve:

<http://www.knowledgeplex.org/showdoc.html?id=188307>

On June 18, 2009, he testified before the House Ways and Means Select Revenue Measures Subcommittee at a joint hearing with the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee: Testimony on the New Markets Tax Credit Program. He suggested ways to improve the program. See:

[http://www.novoco.com/new\\_markets/resource\\_files/advocacy/cunningham\\_testimony\\_061809.pdf](http://www.novoco.com/new_markets/resource_files/advocacy/cunningham_testimony_061809.pdf)

On Wednesday, January 13, 2010 and Monday, June 14, 2010, Mr. Cunningham wrote to Mr. Phil Angelides, Chairman, Financial Crisis Inquiry Commission, to submit testimony and comments to the Commission. In addition, he noted that he was “disappointed that FCIC has not sought out or recognized a broader set of opinions and viewpoints and are further disappointed by FCIC’s lack of ethnic diversity at both the Board and Staff level.”

On July 19, 2010, Mr. Cunningham testified on behalf of the public at the Joint Interagency Public CRA hearings: “The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency jointly held public hearings on modernizing the regulations that implement the Community Reinvestment Act (CRA).” See:

[http://www.fdic.gov/CRAhearings/Individual\\_Presentations.pdf](http://www.fdic.gov/CRAhearings/Individual_Presentations.pdf)

On August 13, 2012, Mr. Cunningham filed a "Friend of the Court" brief in United States Securities & Exchange Commission vs. Citigroup Global Markets Inc. (Second Circuit Court of Appeals Case Number 11-5227). The case concerned the rejection, by a Federal Judge, of a settlement agreed to by the United States Securities & Exchange Commission (SEC) and Citigroup Global Markets Inc. (Citigroup), the latter accused of securities fraud. <http://www.prlog.org/11948760-william-michael-cunningham-files-revised-brief-in-sec-vs-citigroup-2nd-cir-ct-of-ap.html>

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On December 9, 2013, Mr. Cunningham filed a "Friend of the Court" brief in the United States District Court, Central District of California in a case concerning an action that the U.S. Department of Justice, acting on behalf of the United States of America (Plaintiff), brought against McGraw-Hill Companies, Inc., and Standard & Poor's Financial Services LLC, et. al., (Defendants) under 12 U.S.C. § 1833a; 18 U.S.C. §§ 1341, 1343 & 1344. Our comments led to a significant change in enforcement strategy, including the first ever, albeit temporary, rating firm suspension. See: <http://www.prlog.org/12256590-william-michael-cunningham-files-amicus-brief-in-us-vs-sp-us-district-court-central-district-ca.html>

On February 3, 2015, we commented on an effort by Apple Computer, one of the largest holdings in the fund, to utilize women and minority-owned brokerage firms:  
<http://www.usatoday.com/story/tech/2015/02/03/apple-debt-offering-minority-firms-jesse-jackson-diversity-silicon-valley/22805673/>

## **General comments on the proposal**

We agree with others who "see the need for better balance between short- and long-term investing." Unfortunately, little in the Department's regulatory proposal serves to enhance that balance.

This is particularly important. As the market value of environmental, social and governance factors continues to grow, companies and investment managers will engage in fraudulent practices related to these factors. These practices will range from simple falsification of environmental, social and governance records to more sophisticated, but no less fraudulent methods related to environmental, social and governance ratings. We have provided evidence that unethical practices have flourished in capital market institutions and incorporate the following comments by reference:

Comments on Proposed Rule:

Executive Compensation and Related Party Disclosure

[Release Nos. 33-8655; 34-53185; IC-27218; File No. S7-03-06]

<http://www.sec.gov/rules/proposed/s70306/wcunningham6601.pdf>

Comments on Proposed Rule:

Internet Availability of Proxy Materials

[Release Nos. 34-52926; IC-27182; File No. S7-10-05]

<http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf>

Comments on Proposed Rule:

Security Holder Director Nominations

[Release Nos. 34-48626; IC-26206; File No. S7-19-03]

<http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf>

Comments on Proposed Rule:

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# William Michael Cunningham

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Definition of Nationally Recognized Statistical Rating Organization

[Release Nos. 33-8570; 34-51572; IC-26834; File No. S7-04-05]

<http://www.sec.gov/rules/proposed/s70405/wcunningham9442.pdf>

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# William Michael Cunningham

Economist and Social Investing Advisor

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Comments on Proposed Rule:

Securities Offering Reform

[RELEASE NOS. 33-8501; 34-50624; IC-26649 International Series Release No. 1282 File No. S7-38-04]

<http://www.sec.gov/rules/proposed/s73804/cunningham013105.pdf>

## Effective Investing

Our research supports the contention that there is no contradiction between financial goals and an objective of influencing environmental, social and governance factors.

We coined the term "*Effective Investing*" to reflect a style of investing that minimizes costs while maximizing financial AND social return. There are only two ways to accomplish this, stock investing and bond investing. Pension scheme funds should go toward participants' future, not, to an unreasonable degree, to a broker or investment management/mutual fund company fees.

Pension scheme money should be safe and effective investing means being able to sleep at night. This means managing and minimizing risk. There are a limited number of ways to accomplish this, too. Risk is a feature of investing: it is how you get to return. Still, pension schemes can rationally minimize risk by taking a few constructive steps.

In the bond or fixed income world, investing in Government securities is the only way to accomplish this. In the stock market, the strategy is the polar opposite and can be summarized as "don't put all of your eggs in one basket." This means investing in an Index Fund. But, as we have seen with the LIBOR scandal, even this style of stock investing is not free from ethical risk imposed by brokers and other financial institutions.

Finally, *effective investing* means being at peace. This means not investing in companies that are, or that may do "bad" things. This means looking for and investing in responsible companies.

In summary, *Effective Investing*:

*Minimizes fees.*

*Minimizes risk.*

*Maximizes potential financial AND social return.*

See: <http://twisri.blogspot.com/2015/04/effective-investing-how-to-minimize.html>

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# William Michael Cunningham

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## Environmental Issues and Stock Returns

Using data from both old and new sources, Creative Investment Research, Inc. explored and quantified the impact environmental factors have on stock prices using several statistical techniques.

Our research is structured into two parts. In the first, we specify three standard market models and test the hypothesis that environmental factors do, in fact, impact equity prices. In the second part, we examine the impact of a major environmental incident on stock prices, using new data sources and with the assistance of the equity market models specified in phase one.

We created three portfolios based on a ranking of environmental impact forecasts and preparations, as outlined below. The first portfolio returned -21.974% from March 10, 2011 to August 10, 2011. This portfolio consisted of firms with an environmental impact forecast who were well prepared for an environmental incident. The second portfolio consisted of firms with an environmental impact forecast who were marginally prepared for an environmental incident. Returns were +30.686% from March 10, 2011 to August 10, 2011. The final portfolio consisted of firms without an environmental impact forecast who were not prepared for an environmental incident. Returns were -24.036% from March 10, 2011 to August 10, 2011.

Our analysis strongly suggests that investors and publicly traded companies must recognize the impact environmental incidents and issues have on a given firm's ability to use company assets and therefore generate revenue and profits.

We look forward to reviewing your continuing efforts to carry out your mission. We appreciate the time and effort devoted to this task. Thank you for your leadership. Please contact me with any questions or comments.

Sincerely,

*/William Michael Cunningham/*

William Michael Cunningham

Social Investing Adviser for William Michael Cunningham and Creative Investment Research, Inc.

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