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June 21, 2011

VIA ELECTRONIC SUBMISSION

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Release No. 34-64306; File No. 4-626 – Comment Request on Existing Private and Public Efforts to Educate Investors

Dear Ms. Murphy:

The Investor Rights Clinic at Pace Law School, operating through John Jay Legal Services, Inc. ("PIRC"),[1] welcomes the opportunity to comment on the Securities and Exchange Commission study of financial literacy and its forthcoming report to Congress pursuant to section 917 of The Dodd–Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Coincident with the promulgation of the Dodd-Frank Act, Congress identified "financial literacy and underserved investors" as key priorities of the landmark reform legislation and expanded the SEC's ability to protect retail investors to address this concern. Moreover, the Dodd-Frank Act established the Office of Investor Education and Advocacy ("OIEA") to: 1) identify areas where investors could benefit from changes in SEC and/or SRO policies; 2) identify problems between investors and financial service providers and investment products; and 3) assist retail investors in resolving substantial issues with the SEC or SROs.[2]

Financial illiteracy continues to plague American investors, particularly those of modest means. We support the SEC initiative to better understand the details and effectiveness of investor education programs, and recommend additional measures to educate investors as to the nature of risk *before* they invest funds through a brokerage account. In addition, clinics such as PIRC are uniquely positioned to spot problems between the investing public and financial services industry. We thus urge the SEC to consider allocating funds for the continuing operation of non-profit *pro bono* clinics such as PIRC, which provide significant investor educational functions, including extensive outreach, and are often the only place many underserved constituents can turn for assistance.[3]

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[1] Founded in 1997, PIRC is the nation's first law school clinic in which J.D. students, for academic credit and under close faculty supervision, provide *pro bono* representation to individual investors of modest means in arbitrable securities disputes. *See* Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); *see also* Press Release, Securities Exchange Commission, *SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors - Levitt Responds To Concerns Voiced At Town Meetings* (Nov. 12, 1997), *available at* http://www.sec.gov/news/press/pressarchive/1997/97-101.txt (last visited June 19, 2011).
[2] *See*, *e.g.*, Wolters Kluwer Law & Business, *Analysis: Investor Protections under Dodd Frank Act*, Aug. 4, 2010, *available at* http://www.accountingnet.com/x70210.xml (last visited June 19, 2011).
[3] In recent years, the FINRA Investor Education Foundation has provided seed money to law schools to establish investor advocacy clinics, but has been unwilling to fund ongoing operations of previously existing clinics.

Persistent investor illiteracy problems

Investor literacy research conducted over the last decade has demonstrated repeatedly that the investing public is ignorant with regard to financial knowledge, and that disclosure is not an infallible investor protection measure.[4] Many investors do not read written disclosures given to them, whether provided in paper or electronic form.[5] Moreover, numerous recent studies have revealed the true depth of investor illiteracy: no less than 40 million Americans are illiterate and an additional 50 million have marginal reading skills, well below what is required to parse and understand the complex industry jargon commonly found in securities disclosures.[6]

As part of a 2003 study, the NASD defined "investor literacy" as "the understanding ordinary investors have of market principles, instruments, organizations and regulations."[7] The NASD studied "a wide range of investors across income, gender, size of investment portfolio and types of investments," all of which produced dismal findings of investment illiteracy, despite the fact that almost seventy percent of responding investors "described themselves as being 'somewhat knowledgeable' about investing."[8] Despite overly optimistic self-reporting, this study concluded that "fewer than one-fifth of all individual investors (in stocks, bonds, funds, or other securities) could be characterized as 'financially literate."'[9] For example, just slightly more than one-third (35%) of the study's respondents were able to "answer[] . . . seven out of the ten of NASD's Basic Market Knowledge questions correctly."[10] Meanwhile, almost two-thirds (62%) of the surveyed investors either did not know or erroneously believed they were insured against stock market losses, and one-fifth of all investors believed such insurance was actually provided either by the SEC (16%) or the NASD (4%).[11]

FINRA member TD Ameritrade funded similar investment illiteracy research in 2006 that revealed more than half of all surveyed investors incorrectly believed all brokers owe their customers a fiduciary responsibility "to act in [a customer's] best interest in all aspects of the financial relationship."[12] An NASD study from the same year measured investor illiteracy among senior citizens, and determined that, of the 55% of respondents who lost money on an investment, almost one in five "attribute[d] the loss to being misled or defrauded[,][13]and 78% of those misled or defrauded did not report it."[14] This disturbing data translates into approximately

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However, due to the difficult economic climate, coupled with the high expense of clinical legal education, several existing investor advocacy clinics risk closure presently if funding is not located to support continuing operations.

[4] *See*, *e.g.*, Angela Hung, et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (last visited June 19, 2011).

[5] *See* Eliz. MacBride, *What We All Feared: "Better" Disclosures Yields Worse Results, According to Yale Professor's Study*, RIABIZ (Sept. 27, 2010), *available at* http://www.riabiz.com/a/2322116 (last visited June 19, 2011).

[6] *Id.*

[7] Applied Research & Consulting LLC, *NASD Investor Literacy Research*, Executive Summary, at 2 (2003), *available at* http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/ foundation/p118411.pdf (last visited June 19, 2011).

[8] *Id*.

[9] *Id.*

[10] *Id*.

[11] *Id*.

[12] TD Ameritrade Institutional, *Investor Perception Study*, at 1 (2006) *available at* http://rodgers-associates.com/files/investor-perception-study.pdf (last visited June 19, 2011).

[13] NASD, *Senior Investor Literacy and Fraud Susceptibility Survey Executive Summary* (2006), *available at* http://www.finra.org/web/groups/sai/@sai/documents/sai_original_content/p036699.pdf (last visited June 19, 2011).

[14] *Id*.

10% of all senior citizen investors being defrauded at some point—with the majority of defrauded seniors not reporting the fraud. The study also concluded that many "victims of fraud are relatively knowledgeable and active investors."[15]

A 2007 FINRA Investor Education Foundation study determined that "personal relationships factor into senior investor decision making."[16] According to the Electronic Financial Services Council, "[i]nvestors are most vulnerable to high pressure sales tactics when they are interacting personally with a salesperson in whom they have placed their trust and confidence."[17] Two of every five senior investors who participated in the 2007 FINRA study "have hired a broker recommended by a friend, relative, co-worker or neighbor." Nearly three of every five (58%) senior investors who have been defrauded previously have entrusted their investing activity to a broker based on a personal recommendation. At least one academic observer has noted that the presence of a "'truth bias' caus[es] [seniors] to believe what they're told by someone who appears to be authoritative."[18]

A 2008 study commissioned by the SEC and conducted by the RAND Institute for Civil Justice confirmed earlier findings of widespread investor confusion.[19] It determined that almost two-thirds of surveyed investors "think brokers are legally required to act in the best interest of the client; 70% believe that brokers must disclose any conflicts of interest," eclipsing the results of the 2006 TD Ameritrade study.[20] Retail investors generally cannot distinguish between brokers and investment advisers and the different standards of care each owes to customers.[21] According to Jason Zweig of the *Wall Street Journal*, "the confusion is understandable, because a lot of stock brokers these days call themselves financial planners," financial advisors, financial executives and the like.[22]

The use of confusingly similar titles is but one example of industry terminology that is likely to befuddle the investing public, much like the confusion that often arises when a banking customer is exposed to a sales pitch made by a bank-affiliated broker within the confines of the retail deposit-taking space.[23] According to a 2009 FINRA Investor Education Foundation study, financial illiteracy is not restricted to any one cohort of the investing public.[24] However, this troubling trend has actually accelerated among young adults, who are members of a vastly more

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[15] *Id*.
[16] FINRA Investor Education Foundation, *Senior Fraud Risk Survey*, Applied Research & Consulting LLC (2007), *available at* http://www.finra.org/web/groups/investors/@inv/@smart/documents/investors/p036813.pdf (last visited June 19, 2011).
[17] *Promoting Efficient Arrangements Between Portals and Online Brokers* (2000), submitted to the SEC by Intuit, Inc. and the Electronic Financial Services Council, *available at* http://www.sec.gov/pdf/intuitefscpaper.pdf (last visited June 19, 2011).
[18] Jayne W. Barnard, *Deception, Decisions, and Investor Education*, 17 ELDER L.J. 201 (2009).
[19] Hung, et al., *Investor and Industry Perspectives*, *supra* note 4.
[20] Jason Zweig, *The Fight Over Who Will Guard Your Nest Egg*, WALL ST. J. (Mar. 28, 2009), *available at* http://online.wsj.com/article/SB123819596242261401.html (last visited June 19, 2011).
[21] Paul Sullivan, *Broker? Adviser? And What's the Difference?*, NY TIMES, Feb. 17, 2010, *available at* http://www.nytimes.com/2010/02/18/your-money/financial-planners/18TRUST.html (last visited June 19, 2011).
[22] *Id*.
[23] *See* Jill I. Gross & Edward Pekarek, *Banks and Brokers and Bricks and Clicks: An Evaluation of FINRA's Proposal to Modify the "Bank Broker-Dealer Rule,"* 73 ALB. L. REV. 465, 472-75 (2010).
[24] FINRA Investor Education Foundation, *Financial Capability in the United States* (2009), *available at* http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p120536.pdf (last visited June 19, 2011).

financially illiterate generation than their predecessors.[25]

A 2010 study conducted by the FINRA Investor Education Foundation entitled *Financial Capability in the United States*, developed in conjunction with the U.S. Department of the Treasury and the President's Advisory Council on Financial Literacy, found "a significant disparity" in the financial capabilities of Americans on a state-by-state basis.[26] According to the study, an "unprecedented collection of data on financial behaviors across all 50 states" revealed decidedly mixed results.[27] The study's 28,000 respondents, "on average, were able to correctly answer just three of five questions about fundamental financial concepts."[28]

The 2010 study "highlights how many Americans are disadvantaged by their lack of financial capability, and offers a wealth of previously unavailable information on Americans' behavior relating to how they manage their resources and how they make financial decisions."[29] According to FINRA Investor Education Foundation President, John M. Gannon, citing the 2010 study, many Americans "are not well equipped to make financial decision[s]."[30] As recently as last week, a whopping 85% of respondents in a J.D. Power and Associates survey of 4,200 full-service investors had never heard of – or did not understand the differences between – suitability and fiduciary duty.[31] The results are almost certain to be much worse among investors who use discount online brokers.

These studies conducted over the past decade confirm that many investors do not understand fundamental principles of investing. PIRC's anecdotal experience with investors seeking the clinic's free legal services corroborates this conclusion, as some have suffered investment losses due to misunderstandings that could have been avoided with more education during the customer's initial interaction with a retail broker. We recommend that the SEC explore ways to provide simple educational materials to retail investors, including a more objective discussion of the nature of risk.

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[25] FINRA Investor Education Foundation, *Financial Capability in the United States Initial Report, 2009 National Survey* (Dec. 1, 2009), *available at* http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p120536.pdf (last visited June 19, 2011).
[26] FINRA Press Release, *FINRA Foundation Releases Nation's First State-by-State Financial Capability Survey* (Dec. 8, 2010), *available at* http://www.finra.org/Newsroom/NewsReleases/2010/P122538 (last visited June 19, 2011).
[27] FINRA Investor Education Foundation, *State-by-State Financial Capability Survey*, Survey Data, *available at* http://www.usfinancialcapability.org/survey_data.html (last visited June 19, 2011).
[28] *Id*.
[29] *Id*.
[30] John M. Gannon, *Financial Capability in the United States – Report on the National Financial Capability Study – October 2010*, Presentation to the Society for Financial Education and Professional Development (PowerPoint presentation), Nov. 2010, *available at* http://www.sfepd.org/John%20Gannon-National%20Survey%20Summary%20Summary%20Presentation%20sfepd.ppt (last visited June 19, 2011).
[31] Marlene Y. Satter, *J.D. Power: Investors Clueless on Suitability vs. Fiduciary Standards*, ADVISORONE, June 19, 2011, *available at* http://www.advisorone.com/article/jd-power-investors-clueless-suitability-vs-fiduciary-standards (last visited June 20, 2011); Press Release, *J.D. Power and Associates Reports: Despite Efforts to Legislate Greater Accountability from Financial Advisors, Consumer Understanding of The Differences between Fiduciary and Suitability Standards is Low*, June 16, 2011, *available at* http://businesscenter.jdpower.com/JDPAContent/CorpComm/News/content/Releases/pdf/2011084-fsis.pdf (last visited June 20, 2011).

Clinics perform important investor education functions

Those who need information the most are often the least likely to seek it out as they simply do not realize they need investor education. Televised financial media programming and advertising often create the impression that investing is fun and exciting, without describing the many risks involved and the importance of developing investor literacy before putting savings at risk. In fact, it is typically not until an investor's account declines in value that s/he learns the purchased investment product or strategy was not at all consistent with his/her perceptions of it; generally, those perceptions are often shaped by sales rhetoric and literature.

One of the key services *pro bono* clinics such as PIRC provide to underserved investors is listening. PIRC student interns and faculty supervisors listen carefully to investors and their concerns on a regular basis and conduct thorough evaluations of investor complaints. The end result of exacting scrutiny of an investor grievance could be informing the investor that, in our opinion, s/he is not likely to prevail in arbitration. Our clinic may inform an investor that the evidence suggests a broker was perhaps unprofessional, and may even have mistreated the customer, but the conduct was not so egregious as to give rise to a valid legal claim.

Permitting investors to "tell their story" and receive respectful consideration of their complaint is a highly useful function. Procedural justice research consistently reveals that disputants who have had the opportunity to voice their concerns to a third party achieve more satisfaction with the fairness of an outcome than those who are not heard.[32] It is often the end result that a customer can achieve closure and may be relieved to learn that s/he was not likely defrauded or victimized. In turn, customers file claims against broker-dealers and their associated persons less frequently, allocating dispute resolution resources more efficiently to meritorious claims.

Scholarly research

Clinical faculty typically conduct extensive research and produce scholarly work that furthers knowledge in the field. An example of this advancement would include the research that Professors Black and Gross have conducted throughout the years pertaining to perceptions among the investing public regarding the fairness of securities arbitration.[33] This empirical research has provided detailed insight into the views of the investing public and substantially advanced how we think about the process and substance of securities arbitration. This is but one example of many where thinkers in the field of securities law and arbitration, in the clinical setting, expand our collective knowledge.

Investor education outreach

In past years, utilizing grant funding from the New York State Attorney General's Office, PIRC developed, produced and delivered an investor education seminar entitled *Investor Rights and Responsibilities* on more than 20 occasions to numerous audiences, including local libraries,

[32] *See generally*, Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration*, 2 J. DISP. RESOL. 349, 358-59 (2008).
[33] *E.g.*, *id.;* Jill I. Gross & Barbara Black, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, Univ. of Cincinnati Coll. of Law, Pub. Law & Research Paper Series, No. 08-01, 2008, *available at* http://ssrn.com/abstract=1090969 (last visited June 21, 2011).

senior centers and community associations. PIRC staff attorneys and students provided the seminar to local chapters of the New York State AARP, by traveling to counties (and their towns) ranging from Bronx (City Island) and Cattaraugus (Salamanca) to Otsego (Oneonta) and Sullivan (Bethel). Audience feedback was overwhelmingly positive, particularly on the usefulness and clarity of our seminar, as retirees and investors of modest means realized how little they knew about their rights and responsibilities. Many investors asked for further explanation because some of the legal concepts were not explained easily. The most frequent comment we heard was that investors wanted to keep our seminar material for future reference. As a result, PIRC sought funding to convert the seminar to a written guide that we could distribute to investors.

The Investor's Guide

Funded by the FINRA Investor Education Foundation, PIRC drafted, designed, produced and published *The Investor's Guide to Securities Industry Disputes*,[34] now in its second edition. This 35-page guide uses plain language to make sense of the dispute resolution options available to investors with disputes arising from activity in their brokerage accounts. The *Investor's Guide* describes the fundamental characteristics and basic rules of the arbitration and mediation processes offered by FINRA. The *Investor's Guide* also provides an overview of investors' rights and responsibilities, as well as the duties brokers owe to their customers.

PIRC distributed the first edition of the *Investor's Guide* nationally, including to some of the *pro bono* clinics at law schools located throughout the United States. Distribution has been performed with prominent assistance by a number of state Attorneys General, primarily through consumer protection and securities departments. Among them, the Attorney General's office for the state of Maryland distributed hundreds of copies of the *Investor's Guide* at its state fair, with an aim towards improving the financial knowledge of farmers and their families. PIRC has also distributed the publication in cooperation with rural library systems in a program spearheaded by the FINRA Investor Education Foundation. Similarly, the University of Florida distributed hundreds of copies through its Department of Family Youth and Community Sciences. Other avenues for physical distribution have included bar association events, academic fairs, and with every investor inquiry. Distribution of the second edition commenced recently. In total, approximately 7,500 print versions of the *Investor's Guide* were distributed in recent years.

The *Investor's Guide* also has been distributed electronically, via email, blog and social media postings. It has been uploaded to several important websites, including the free publications website of the American Bar Association Section of Dispute Resolution, and a federal government site designed for consumer protection.[35] PIRC has received favorable feedback on the guide from lawyers looking for a tool to explain arbitration and mediation processes to their clients in simple terms. FINRA Dispute Resolution also reports a favorable response from its constituents.

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[34] *The Investor's Guide to Securities Industry Disputes - How to Prevent and Resolve Disputes with Your Broker*, Jill Gross, et al. (eds.) (2011), *available at* http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p119054.pdf (last visited June 19, 2011).
[35] *See, e.g.*, Saving and Investing, *available at* http://www.usa.gov/Citizen/Topics/Money/Investing.shtml (last visited June 20, 2011).

Investor education needs

Despite these successful investor education efforts, better education regarding the concept of risk is crucial. Brokers are by nature risk-takers and their understanding of "low risk" versus "high risk" is quite different from that of a retail customer's perception. Precise definitions that explain product and strategy risks to customers at the point-of-sale would be of great benefit, including additional "plain English" disclosure summaries of products—not just the investment objectives of particular mutual funds.

Results of the June 2011 JD Power and Associates study indicated that investors want written financial plans, clear communication regarding reasons for investment performance, explanations about how fees are charged, and discussions about risk tolerance changes and incorporation of risk aversion adjustments into investment plans, when appropriate.[36] Point-of-sale disclosures and education pertaining to products that are frequently substituted for CDs should be improved greatly, with plain language explanations of the fundamental differences between bank savings and securities investments products. A widely publicized national hotline, website and/or email address contact for investors to obtain investing information, not legal advice, would be a resource of great value to the investing public.

Conclusion

More than a decade of research has established convincingly that the investor illiteracy problem in the United States is profound, even with respect to some of the most basic financial concepts. Congress has identified it as a high priority for financial services regulatory reform, particularly for underserved investors. Disclosure is no panacea for the dilemma, and is instead but one part of an effective solution.

While some strides have been taken to communicate relevant investing information, substantial room for improvement remains. As former Chairman Arthur Levitt rightly envisioned, *pro bono* law school clinics can and do offer the investing public an array of education and advocacy resources, especially for underserved investors of modest means. Unfortunately, permanent funding for investor advocacy clinics is virtually non-existent at most law schools. With additional support, law school clinics could do even more to protect the investing public, which would only enhance market integrity. We believe the SEC should allocate operational funding for law school clinics so they may continue to provide critical services for the investing public that are simply not available anywhere else.

Respectfully submitted,

Jill Gross

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[36] *See J.D. Power and Associates Reports*, *supra* note 31.