FINRA
Financial Industry Regulatory Authority

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Senior Vice President
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March 26, 2012

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. 4-645, Comment Request for Study Regarding Financial Literacy Among Investors

Dear Ms. Murphy:

The Financial Industry Regulatory Authority (FINRA)[1] staff is pleased to respond to the Commission's request for comment on its study of financial literacy among investors.[2] As mandated by the Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), the Commission is reviewing a broad range of issues and specifically seeks comment on the issues described in Section 917(a)(2)-(4). Generally, these involve how to improve the timing, content and format of disclosures to investors with respect to financial intermediaries, investment products and investment services; the most useful information for retail investors to make informed financial decisions; and methods to increase the transparency of expenses and conflicts of interests in transactions involving investment services and products.

In a previous letter, FINRA provided a detailed description of the investor education programs and services provided by FINRA and the FINRA Investor Education Foundation, which we believe demonstrate effective ways to educate investors and

[1] The Financial Industry Regulatory Authority (FINRA) is the largest independent regulator for all securities firms doing business in the United States. All told, FINRA oversees nearly 4,600 brokerage firms, about 164,000 branch offices and approximately 632,000 registered securities representatives. FINRA is an independent, not-for-profit organization with a public mission: to protect America's investors by making sure the securities industry operates fairly and honestly. FINRA's independent regulation plays a critical role in America's financial system and touches virtually every aspect of the securities business—from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest dispute resolution forum for investors and registered firms.

FINRA has approximately 3,000 employees and operates from Washington, DC, and New York, NY, with 20 regional offices around the country. FINRA's activities are overseen by the U.S. Securities and Exchange Commission (SEC), which approves all FINRA rules and conducts regular oversight examinations of FINRA operations.

[2] *See* Securities Exchange Act Rel. No. 66164 (Jan. 17, 2012) (Request for Comment).

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provide them with tools to inform themselves about financial service providers and investment products.[3] This letter addresses the specific issues raised in the Commission's Request for Comment.

As the Commission considers ways to improve disclosure, we respectfully suggest that effective disclosure often does not fit neatly into one-size-fits-all determinations. In our view, disclosure is most effective when mandatory disclosure documents are presented in a manner that allows an investor easily to a) compare alternative investment choices and b) navigate the disclosure to focus on those areas of particular concern or interest to the individual.

As described below, we believe that point of sale disclosure can be a powerful means of improving investor understanding of investment options. In addition to mandatory disclosure, FINRA believes that tools and calculators can help investors make more informed decisions about their savings and investment needs, investment products and services, and financial professionals. This letter describes some of the many tools that FINRA has developed to assist investors. Finally, we urge that the format of disclosure be guided wherever possible by research, including market research and testing to elicit consumer feedback, subject to rigorous independent evaluation. In this regard, we describe some of the many disclosure research initiatives funded by the FINRA Investor Education Foundation.

Point of Sale Disclosure

Mandatory disclosure requirements are essential in ensuring that investors receive useful, relevant information in a timely and effective manner. In this regard, we urge the Commission to improve investor understanding by adopting point of sale disclosure requirements along the lines recommended by FINRA (then NASD).[4] In our view, effective point of sale disclosure that primarily employs Web-based delivery strategies will help ensure that investors receive key information about financial intermediaries and products at the time at which it is most useful – the point of sale.

The issue of point of sale disclosure arose in the context of mutual fund sales when the Commission proposed that broker-dealers provide specified disclosure about mutual funds at point of sale and in confirmation statements.[5] Point of sale disclosure has

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[3] *See* letter from Marcia E. Asquith, Senior Vice President and Corporate Secretary, FINRA, June 21, 2011 (available at http://sec.gov/comments/4-626/4626-59.pdf). Established by FINRA in 2003, the FINRA Investor Education Foundation aims to provide underserved Americans with the knowledge, skills and tools necessary for financial success throughout life.

[4] *See, e.g.,* letters from NASD executives (dated August 5, 2005, March 31, 2005. and March 29, 2005) concerning File No. S7-06-04 (Point of Sale Disclosure for Transactions in Certain Mutual Funds and Other Securities, Reopening of Comment Period and Supplemental Request for Comment)

[5] Proposed rule and form amendments would require broker-dealers to provide certain information about mutual fund costs and dealer incentives at the point of sale and in confirmation statements. *See* SEC Rel. No. IC-26341 (Jan. 29, 2004), 69 Fed. Reg. 6438 (Feb. 10, 2004) (the "Point of Sale Proposal"). The

relevance for providing effective disclosure across a wide range of complex products, and we respectfully suggest that our recommendations regarding mutual funds provide an excellent starting point for any broader efforts.[6]

In light of its concerns regarding the quality of mutual fund disclosure, FINRA (then NASD) established a Task Force of senior industry experts and academics in 2004 to consider these issues.[7] The Task Force proposed a new point of sale disclosure document, the "Profile Plus," that would give investors key information whenever a broker-dealer recommends a mutual fund. In our view, the type of information in the Profile Plus may be useful for the Commission to consider if it develops summary disclosure documents for other investment products or services. The Profile Plus builds upon the point of sale disclosure proposed by the SEC in 2004, but differs in certain key respects:

<u>Mode of Delivery</u> - The SEC proposal would have required delivery either orally or in hard copy. The Task Force recommended Internet delivery at the point of sale, unless an investor opts for more traditional paper or oral delivery.

Because a broker-dealer would be required to post on its website a Profile Plus for every fund that it offers, an investor easily would be able to compare different funds.[8] Internet

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Commission issued a supplemental request for comment on point of sale disclosure. *See* SEC Rel. No. IC-26778 (Feb. 28, 2005), 70 Fed. Reg.10521 (March 4, 2005) (the "Supplemental Request for Comment").

[6] Other initiatives likely will be instructive in this regard. For example, as mandated by Dodd-Frank, the Commission submitted a staff report to Congress in January 2011 on the legal and regulatory standards that apply to broker-dealers and investment advisers when providing personalized advice to retail investors. Most significantly, the report recommends that the Commission use its rulemaking authority granted by Dodd Frank to establish a uniform fiduciary standard for broker-dealers and investments advisers when providing this type of personalized advice. As part of this effort, the report recommends that the Commission "facilitate the provision of uniform, simple and clear disclosures to retail investors about the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interest."

FINRA also is considering ways to improve the disclosure provided to retail investors. For example, *Regulatory Notice* 10-54 requests comment on a concept proposal to require broker-dealers, at or prior to entering a business relationship with a retail customer, to provide a written statement to the customer describing the types of accounts and services it provides, as well as conflicts associated with such services and any limitations on the duties the firm otherwise owes to retail customers.

[7] NASD formed the Mutual Fund Task Force in 2004 to provide guidance to the SEC on issues relating to soft dollars, mutual fund portfolio transaction costs and distribution arrangements. The Task Force was comprised of senior industry executives who represent broker-dealers and mutual fund management companies, as well as representatives from the academic and legal communities. The Mutual Fund Task Force submitted two reports to the Commission. *See Report of the Mutual Fund Task Force: Mutual Fund Distribution* (March 24, 2005) and *Report of the Mutual Fund Task Force: Soft Dollars and Portfolio Transaction Costs* (November 11, 2004). In a submission to the SEC, NASD endorsed the Task Force recommendations. *See* letter from Robert R. Glauber, Chairman, NASD, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (March 31, 2005).

[8] The Task Force recommended that a broker-dealer be required to refer an investor to the website disclosure. An investor, of course, would be able to opt out of Internet delivery.

delivery avoids the confusion and delay that may accompany oral or hard copy delivery, and permits an investor to tailor disclosure according to his needs. If an investor wishes to review only the Profile Plus, he could do so. If he desires more detailed information about the fund, Internet delivery allows each Profile Plus to include hyperlinks that allow an investor instantly to access further information.

Content of Disclosure - The disclosure in the Profile Plus differs in these ways:

- Like the SEC proposal, the Profile Plus would disclose conflicts of interest, fees and expenses. Unlike the Commission proposal, it also would include information about the fund's investment strategies, risks and other significant features. Hyperlinks to the fund prospectus would allow an investor to review more information about each aspect of the fund.

- A revised version of the Profile Plus (revisions made after we initially submitted the Profile Plus to the SEC) would provide automatic calculation of sales charges after the investor fills in his or her investment amount. The Profile Plus also would provide a hyperlink to FINRA's Fund Analyzer, which would permit an investor easily to calculate the impact of sales charges and annual expenses on various potential investment amounts.

- The Profile Plus would include the fund's portfolio turnover rate and a brief explanation of the significance of portfolio transaction costs. A hyperlink would provide instant access to further information in the fund prospectus.

- Based on the results of investor research, the Profile Plus would *not* break out the fund expense ratio into component costs; this information, however, would be readily available through the hyperlinks to the fund prospectus.

- Like the SEC proposal, the Profile Plus would include yes/no questions that alert investors to the existence of revenue sharing and differential compensation arrangements. The Profile Plus, however, would include hyperlinks to dealer disclosure statements that would provide investors with rankings of fund families both in terms of revenue sharing payments made to the broker dealer and in terms of differential compensation arrangements.

Investor Tools

Another way to allow investors to tailor the information they receive to meet their individual needs is through tools and calculators that help them make smarter investment decisions. FINRA provides numerous types free of charge, including:

- **FINRA BrokerCheck®** provides information on the professional background of current and former FINRA-registered firms and brokers. BrokerCheck can be a first step in selecting an investment professional, and a means of checking a broker or firm periodically. In 2011, more than 22.53 million searches yielded nearly 14.22 million records being viewed for the nearly 1.35 million current and former securities brokers listed on BrokerCheck. In addition, investors downloaded more than 5.54 million reports.

FINRA recently requested comment on ways to facilitate and increase investor use of BrokerCheck information, including potential changes to the information disclosed through BrokerCheck, the format in which the information is presented and strategies to increase investor awareness of BrokerCheck. *See* Regulatory Notice 12-10, FINRA Requests Comment on Ways to Facilitate and Increase Investor Use of BrokerCheck Information (Feb. 22, 2012).

- **FINRA's Fund Analyzer** allows investors to compare the impact of fees and expenses on the performance of more than 23,000 mutual funds, exchange-traded funds and exchange-traded notes, and to look up applicable fees and available discounts. Investors can research one fund at a time or compare the costs of as many as three funds or classes of a single fund. During 2011, the Fund Analyzer received 314,535 visits—more than 26,000 per month on average.

- **FINRA's Market Data Center** offers detailed market data on equities, options, mutual funds and a wide range of bonds, including corporate, municipal, Treasury and agency bonds. The Market Data Center also provides familiar equities indices, as well as FINRA-Bloomberg Active U.S. Corporate Bond Indices for investment-grade and high-yield bonds. In 2011, the Market Data Center received 234,002 visits.

- **FINRA's Professional Designations Database** helps investors decode the strings of letters that sometimes follow an investment professional's name and determine which professional is suitable for their particular needs. During 2011, the Professional Designations Database received 47,637 visits.

Other tools for investors include the Risk Meter, which allows investors to determine if they share characteristics and behavior traits that have been shown to make some investors vulnerable to investment fraud; the Scam Meter, which assesses whether an investment opportunity is too good to be true; and our Required Minimum Distribution Calculator, which helps investors determine how much they are required to withdraw from a traditional 401(k) or IRA. More tools and calculators available to investors can be reviewed by visiting www.finra.org/investors/tools.

Research

In our view, research that rigorously examines investor behavior and preferences is critical to determine how best to improve the content, timing and format of disclosure. Since its formation in 2003, FINRA Foundation has approved approximately $68.4 in financial education and investor protection initiatives through a combination of educational and research grants, as well as targeted projects managed directly by the FINRA Foundation. A number of FINRA Foundation-funded research grants examine methods to improve investor disclosures. While each of the projects listed below contributes to the dialogue of how to improve disclosure, a study by researchers at the University of Connecticut-Stamford directly addresses the use of visual cues to improve investor comprehension and retention of disclosure information.

Visual Priming:

In *Effects of Visual Primes on Improving Web Disclosure to Investors*,[9] researchers from University of Connecticut-Stamford examined the effects of different types of visual cues in Web-based disclosure information on investors' comprehension and retention of the information presented. A series of experiments compared three different types of visual primes were aimed at making important disclosure information more noticeable: semantic (using words to signal importance), categorical (using drop-down menus to guide the reader to key topics) and feature (using icons, such as a "Caution" sign). The research also examined how different visual primes affect expert versus novice investors. Specifically, the study sought answers to the following questions:

1. Can disclosure information be primed to be salient visually online?
2. Will visual primes enhance investors' comprehension and retention of disclosure information?
3. How effective are different types of visual primes—that is, semantic, categorical, feature and control—of online disclosure information in affecting novice and expert investors' comprehension and retention of disclosure information?

Among key findings, the researchers determined that visual priming can positively affect investors' processing of disclosures since visual primes can attract their attention and make the disclosures noticeable. This is particularly true for novice investors. In addition:

- Semantic priming—a written instruction that stated "Please read the following disclosure information"— was the condition that had consistent and positive effects. Overall, semantic priming was the best condition to increase attention of and help process, understand and recall disclosure information, regardless of knowledge level.
- Categorical priming was the most helpful condition for participants to understand and process disclosure information, regardless of knowledge level, while feature priming was the least helpful for understanding and processing of the disclosure information.
- Feature and semantic priming were the most visually attention getting.

[9] A. Wang & T. Dowding, *Effects of Visual Primes on Improving Web Disclosure to Investors*, (2007) (available at http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118415.pdf). The results were also published in THE JOURNAL OF BEHAVIORAL FINANCE, 11: 11–20, 2010 (available at http://sp.uconn.edu/~alw03009/JBF-11(1)-2010.pdf).

- Knowledge level rather than visual priming was the predominant factor for comprehension and recall of the information. Nevertheless, semantic priming was the best "leveler" of the knowledge gap.

Finally, the researchers recommended that an integration of visual primes be considered. For example, feature or semantic priming with categorical priming should be integrated and used to help online investors process, understand and remember disclosure information when making important investment decisions.

Additional Disclosure Research:

The following research, funded by the FINRA Foundation, might prove helpful to the staff as it prepares the study required by Section 917 of Dodd-Frank:

- ***How Does Simplified Disclosure Affect Individual's Mutual Fund Choices?***
  National Bureau of Economic Research, Cambridge, MA (released 2010)
  (http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p121994.pdf)
  Key Finding: Short-form disclosure for mutual funds does not help investors think about loads and therefore does not help investors make informed investment decisions.

- ***Can Psychological Aggregation Manipulations Affect Portfolio Risk-Taking?***
  National Bureau of Economic Research, Cambridge, MA (released 2010)
  (http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p121993.pdf)
  Key Finding: Contrary to previous studies, these experiments (conducted prior to the market collapse of 2008) demonstrate that, in a setting closer to a real-world investment environment, aggregating information about portfolio performance does not increase people's willingness to take investment risks.

In addition, a series of papers prepared by researchers at the University of Central Florida and Bentley University and released in 2009 address investors' use of disclosure information in the Management Discussion and Analysis section of annual reports on Form 10-K:

- *Where do Investors Prefer* to *Find Nonfinancial Information?*
  (http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118444.pdf)

- *The Impact of Information Tagging in the MD&A on Investor Decision Making: Implications for XBRL*
  (http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118442.pdf)

  The Impact of Risk on Investor Decision Processes and Outcomes in the Post-

Sox Environment
(http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118445.pdf)

- *Understanding Professional and Non-Professional Investors' Information Requirements*
(http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p118443.pdf)

Further information about these and other research projects funded by the FINRA Foundation may be found at www.finrafoundation.org.

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We hope these comments are helpful as the Commission conducts its study of financial literacy among investors, and we thank you for the opportunity to express our views on these important issues. Please contact Gerri Walsh, president of the FINRA Foundation and head of FINRA's Office of Investor Education, at Gerri.Walsh@finra.org or Angela Goelzer, vice president of FINRA's Office of Investment Companies, at Angela.Goelzer@finra.org if you have any questions.

Very truly yours,

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