



April 20, 2012

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

**RE: Release 34-66164; File Number 4-645; Comment Request for Study  
Regarding Financial Literacy Among Investors**

Dear Secretary Murphy:

AARP<sup>1</sup> is pleased to respond to the request for comments on the Commission's "Study Regarding Financial Literacy Among Investors." The study, mandated by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, seeks to identify methods to improve the timing, content and format of disclosures to investors about financial intermediaries, investment products, and investment services.

While the Commission and segments of the securities industry have in the past attempted to create a more effective disclosure regimen, clearly there is a need for new energy, commitment, and focus on this important regulatory activity. Indeed, AARP supports an agency-wide effort to ensure an ongoing and consistent approach to updating the content, format and delivery of mandated disclosure that reflects the evolving financial marketplace as well as technological advances.

**Executive Summary**

Federal securities laws and regulations protect investors in large part through disclosure of information about investment opportunities and financial professionals. However, many investors currently do not enjoy these protections because the disclosures made under the federal securities laws are either incomprehensible, come too late in the decision-making process, or both. In other instances, information is available but not required to be affirmatively provided to investors, who then must know to seek and obtain it on their own. Today, entire segments of retail markets are in large part undisciplined by market forces due to the lack of transparency caused by ineffective disclosure. The result: inefficient

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<sup>1</sup> AARP is a nonprofit, nonpartisan membership organization that assists our members and people 50+ to have independence, choice and control in ways that are beneficial and affordable to them and to society as a whole. AARP is dedicated to enhancing quality of life for all as we age. We lead positive social change and deliver value to members through information, advocacy and service.

markets, abusive sales practices, and investor losses. This in turn saps investor confidence and weakens the capital markets.

This is particularly dangerous in an era when individuals shoulder the primary responsibility for making appropriate investment choices to assure adequate income to fund their retirement years. According to the latest publicly available data from the Investment Company Institute, in 2011 more than 52 million U.S. households, or about 44 percent, owned mutual funds.<sup>2</sup> The median age of individuals heading households that owned mutual funds was 50.<sup>3</sup> Thirty-two percent of mutual fund-owning households held mutual funds solely inside employer-sponsored retirement plans that include defined contribution plans and employer-sponsored IRAs; 31 percent owned funds solely outside these plans, and 37 percent had funds both inside and outside employer-sponsored retirement plans.<sup>4</sup>

In the latest Gallup poll of investors released a year ago, 54 percent of Americans said they hold individual stocks, stock mutual funds, or stocks in their 401(k) or IRA.<sup>5</sup> Although self-reported stock ownership has trended downward since 2007 when 65 percent of Americans owned stock, more than half of adult Americans rely on the stock market to help fund their retirement.

Despite the “democratization” of the financial markets, few of the mandated disclosures are designed with the average, middle income investor in mind. Instead, too many disclosures are written to satisfy regulatory requirements rather than to help inform investors. Documents often are dense, legalistic, and appear designed to reduce liability rather than promote informed decision-making by retail investors. Some disclosures come too late in the process to be of any use whatsoever to investors. AARP encourages the Commission to be bold when it comes to reforming the disclosure practices in the securities markets to promote better decision-making by investors.

While strongly supportive of efforts to dramatically improve disclosures, we must also sound a word of caution. Efforts at increasing understanding about the financial professionals with whom investors do business and the investment products they purchase are necessary, but there are limits to the protections that even vastly improved disclosures can provide to investors. While absolutely essential to a well-functioning investment marketplace, disclosure is no substitute for smart and effective securities law regulation and enforcement.

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<sup>2</sup> Profile of Mutual Fund Shareholders, 2011, Investment Company Institute, February 2012, p. 5 available at [http://www.ici.org/pdf/rpt\\_12\\_profiles.pdf](http://www.ici.org/pdf/rpt_12_profiles.pdf)

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*

<sup>5</sup> “In U.S., 54% Have Stock Market Investments, Lowest Since 1999,” Dennis Jacobe, Chief Economist, Gallup, April 20, 2011, available at [www.gallup.com/poll/147206/stock-market-investment-lowest-1999](http://www.gallup.com/poll/147206/stock-market-investment-lowest-1999)

## **Timing, Content, and Format Recommendations**

While we address disclosure issues specific to financial intermediaries and investment products in the next sections, there are recommendations related to timing and format that apply to both. Common recommendations are summarized here.

**Timing.** Commission decisions as to when disclosures should be made to investors are a critical consideration in fostering informed decision-making, as opposed to simply checking a box and providing “after the fact” paper. Today, the timing of disclosure requirements varies widely, sometimes even for the same activity but under different laws. For example, investment advisers generally have to provide certain information before engaging in a fiduciary relationship with a client, but brokers operating under a suitability standard do not have the same disclosure requirements. In general, mutual fund disclosures must be delivered in advance of purchase. The same is not true for disclosures with respect to other investment products. AARP recommends that the timing of disclosure requirements be standardized for all financial intermediaries and across all products.

With respect to all financial intermediaries, we encourage the Commission to require sufficient disclosure prior to a financial engagement to allow the investor to make a well-informed choice. Among the baseline set of pre-engagement disclosures that should be required include conflicts of interest, fees and costs, background and disciplinary record of the provider, and scope of representation.

With respect to investment products, we recommend that investors be provided summary disclosures about recommendations at the time of the recommendation, and prior to the investor making a decision to commit funds to a specific investment opportunity. This would require certain disclosures even prior to the point-of-sale. That way, an investor could make an informed choice when it comes to evaluating investment recommendations.

**Content.** There is clear evidence that voluminous and legalistic disclosure documents do not meet the test of effective disclosure for retail investors. Instead, summary disclosures are more likely to be read and used by investors when considering investment options. There are some hopeful signs that a “layered” disclosure approach, whereby investors are provided a summary document with the option of more detailed information in key areas, may be an effective approach to securities market disclosure.

A key consideration in the decision regarding what content should be included in the disclosure is the need for investors to be able to compare key pieces of information when it comes to making a decision about a financial adviser or investment product. Therefore, fostering comparability should be a goal of improved disclosure. For example, when it comes to fees, a number in and of itself is meaningless if an investor doesn’t know how it compares to industry norms or other products.

**Format.** AARP encourages the Commission to use information design professionals when it comes to creating disclosure documents that truly will help foster informed decision-making by investors. The good news is that there is a profession that exists to take on this challenge. It is the job of information design professionals to make complex information understandable. Information designers know how to solicit information from investors,

securities lawyers, accountants, investment professionals and others, and to take that information and create effective disclosures. Through well-established and disciplined protocols and testing regimes, they know how to create, test and design disclosures that work for retail investors.

Testing proposed disclosures is a key element of the design process. The measure should be whether the disclosures are effective in conveying the relevant information in a way that promotes understanding and encourages investors to act on that information.

AARP further encourages the Commission, whenever possible, to require both written and oral disclosure rather than rely solely on oral disclosures that can be incomplete and thus less desirable when it comes to informed decision-making. However, some research shows that written disclosure alone without an oral summary may be ignored or misunderstood. How the disclosure documents are delivered to investors is another issue for Commission consideration. Certainly, technological advances and widespread use of electronic communications open up tremendous possibilities when it comes to improving the quality and accessibility of disclosures, while at the same time reducing the cost of providing the disclosures. However, investors of all ages, and not just older investors, have been resistant to using electronic disclosures. For that reason, alternatives to electronic delivery must be provided.

### **Improving financial intermediary disclosure**

Investor advocates agree that a top priority for the Commission should be improving disclosure related to financial intermediaries. Research conducted by the Consumer Federation of America (CFA)<sup>6</sup> found that for many investors the decision about whom to rely on for recommendations is the most important investment decision they will make. According to CFA research, most people who invest through a broker, financial planner, or investment adviser do little or no research about the investments they make. Instead, they rely almost exclusively on the recommendations they receive from that investment professional.<sup>7</sup>

At the same time, there is considerable evidence<sup>8</sup> that typical investors are confused about the nature of the services offered by their financial professionals. Many investors do not understand the key distinctions between investment advisers and broker-dealers: their duties, the titles they use, the services they offer, or the fees they charge. Investors who do not understand the differences between brokers and advisers nonetheless rely heavily

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<sup>6</sup> “Mutual Fund Purchase Practices: An Analysis of Survey Results,” Barbara Roper and Stephen Brobeck, Consumer Federation of America, June 12, 2006, available at [http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/mutual\\_fund\\_survey\\_report.pdf](http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/mutual_fund_survey_report.pdf)

<sup>7</sup> *Ibid.*

<sup>8</sup> See for example, U.S. Investors & The Fiduciary Standard, A National Opinion Survey conducted by ORC, September 15, 2010; and Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov, RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, commissioned by the Securities and Exchange Commission, 2008

on the recommendations they receive, making them vulnerable to sales pitches misrepresented as objective advice.

Despite this blurring of the lines between investment advisers and brokers, today it is only investment advisers who must provide comprehensive pre-engagement disclosure to investors. In 2011, the SEC updated the disclosure form that investment advisers provide to investors<sup>9</sup>, greatly improving its usefulness. When it adopted the amendments to Form ADV, the SEC noted that the brochure provided investment adviser clients with information that was “critically important” in determining whether to engage the adviser. Given that most investors do not understand the distinctions between brokers and investment advisers and the comparable level of trust placed in both categories of financial professionals by investors in general,<sup>10</sup> AARP believes the disclosure obligations of these two sets of financial intermediaries should be harmonized.

While we are not endorsing the wholesale application of the Form ADV Part 2 requirements for all financial intermediaries, the types of disclosure requirements that have been deemed beneficial to investment adviser clients are also important for clients of other financial intermediaries. These types of disclosures, when appropriately tailored, provide a framework for an improved disclosure regime for all brokers. A starting point here may be the proposal issued by the Financial Industry Regulatory Association (FINRA) in October 2010.<sup>11</sup> The proposal would require brokers to provide retail investors with a plain English disclosure brochure before or at the time a business relationship is entered into. Like the Form ADV Part 2 for investment advisers, the brochure would cover a number of key issues, including the accounts and services offered by the firm, its associated conflicts of interest, and any limitations on duties owed to the customer. The greater the transparency of compensation and related conflict information, the better informed the investor will be regarding the broker’s recommendations when deciding among recommended products or services. AARP would also support the disclosure of a disciplinary record in this document.

To be most useful, the broker disclosure document should be in a standardized and easy-to-read format; it should be provided to retail customers who contact a retail broker-dealer to effect a transaction or open an account; and it should be provided either prior to or contemporaneously with the time an account is opened. Also, like the delivery

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<sup>9</sup> Rules Implementing Amendments to the Investment Advisers Act of 1940, Securities and Exchange Commission, June 22, 2011, available at <http://www.sec.gov/rules/final/2011/ia-3221.pdf>

<sup>10</sup> For example, in six state-specific opinion polls conducted by AARP during consideration of the Dodd-Frank Wall Street Reform bill, residents at least 50 years old were asked questions related to the various investor and consumer reforms under consideration. Overwhelmingly, respondents favored requiring financial professionals to put the client’s interest ahead of their own when making recommendations, as well as disclosing upfront any fees or commissions they earn and any conflicts of interest that potentially could bias that advice. The level of support for this reform ranged from a low of 88 percent (Arkansas) to a high of 95 percent (Indiana). Indeed, many investors believed **all** financial professionals had a fiduciary duty. To view the state-specific surveys, go to [http://www.aarp.org/money/scams-fraud/info-04-2010/finprotect\\_states.html](http://www.aarp.org/money/scams-fraud/info-04-2010/finprotect_states.html).

<sup>11</sup> Regulatory Notice 10-54, “FINRA Requests Comment on Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship,” October 2010.

requirements associated with the investment adviser Brochure Rule, broker-dealers should be required to deliver or offer to deliver a current copy of the document annually.

A key consideration in designing pre-engagement disclosure documents for all financial intermediaries is the ability of an investor to easily compare the information so that they know what type of service they are most interested in receiving. As stated in the general comments above, we favor using professional information design experts to develop and test the disclosure documents to ensure the information covered is useful in investor decision-making.

Finally, improving financial intermediary disclosure, as recommended here, is essential but in and of itself not sufficient to fully protect investors. As such, AARP encourages the Commission to also move forward with rulemaking to require that all financial intermediaries who provide personalized investment advice to retail clients do so under a uniform fiduciary standard of conduct.

### **Improving investment product disclosure**

As is true with disclosure related to financial intermediaries, disclosure requirements vary considerably across investment products. The primary focus of improved disclosure efforts have been in the context of mutual funds, in recognition of the predominant role they play in the investments of most Americans. However, the policy goals underlying mutual fund disclosure are no less valid for other investment products. The Commission should develop improved disclosures for all types of investment products.

Simple, clear communications can help investors make investing decisions that are in their best interest, particularly if the materials are provided at a point in their decision-making to be useful and in a format they understand. It may be that the summary prospectus now used by some mutual funds can serve as a model for disclosure across investment products. The Commission should determine, for each investment product, the essential information that retail investors need for informed decision-making, and then require that information to be made available prior to the sale. This must be done in a concise, professionally designed, easy to understand, and standardized format that readily allows for comparisons among providers and products. Additional information should be provided to investors who request it.

### **Conclusion**

There is widespread agreement that the goals of disclosure policy should be to ensure that investors get the information they need, in a format they can use and understand, and at a time when it is most helpful in their decision-making process. At the same time, it bears repeating that efforts to better educate investors through improved disclosure, while desirable, is no substitute for effective regulation and enforcement.

The many ongoing efforts to improve financial literacy among investors would have a greater chance of success if there were not a different set of messages for each industry and investment product. Disclosure policies that apply common principles across industries and product lines would simplify these efforts considerably. There would be a

real educational benefit in providing substantial uniformity in the timing, content and format of financial disclosures for service providers and for products that are sold for essentially the same financial purpose.

AARP encourages the Commission to move forward on the recommendations made in this submission and those of other investor advocates. We stand ready to assist the Commission in any way possible to accomplish the mutual goal of improved and harmonized disclosure requirements for financial intermediaries, investment products and investment services.

If you need additional information or have questions, please contact Mary Wallace by email at [mwallace@aarp.org](mailto:mwallace@aarp.org) or by phone at (202) 434-3954.

Sincerely,

A handwritten signature in black ink, appearing to read "David Certner", with a long horizontal flourish extending to the right.

David Certner  
Legislative Counsel & Legislative Policy Director  
Government Affairs