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March 23, 2012

By Electronic Mail

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

Re: Comment Request for Study Regarding Financial Literacy Among Investors

Dear Ms. Murphy,

Fi360, Inc. ("fi360")[1] appreciates the opportunity to provide comment as part of the Securities and Exchange Commission's ("SEC" or the "Commission") study on financial literacy.

This study, which is mandated by §917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), seeks to improve the timing, content, and format of disclosures to assist investors in becoming better informed when purchasing a retail product or engaging a financial intermediary. We are pleased to provide our observations regarding a growing awareness and sensitivity by educators, Congress, regulators and others to investors' lack of basic investing knowledge – a financial literacy issue that the Commission's report seeks to address. Our letter specifically addresses the issues in Sections 917(a)(2)-(4) of the Dodd-Frank Act and identified in the Commission's request for comment, but first we feel it is important to set the context for how financial literacy is defined.

Definition of Financial Literacy

[1] Fi360 offers a full circle approach to investment fiduciary education, practice management, and support. Fi360's mission is to promote a culture of fiduciary responsibility and improve the decision making processes of investment fiduciaries, including investment advisors, managers, and stewards. With legally substantiated Practices as the foundation, fi360 offers training, tools, and resources in support of that mission. Fi360 also manages the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst™ (AIFA®) designation programs. At present, there are more than 5,600 active AIF and AIFA designees. For more information, please go to www.fi360.com.

The first issue that the SEC should consider for purposes of its study is how to define financial literacy in the context of investing. There is no universal definition for financial literacy, although a brief review of the literature suggests U.S. education and nonprofit organizations have similar descriptions. Based on these descriptions, financial literacy involves possessing the basic financial skills needed to take effective action in meeting individual or household goals.[2]

Given the SEC's jurisdictional boundaries within the securities markets, we believe that the definition of financial literacy with respect to the study should be narrowed to the subset of topics covering investments and related liquidity issues.

For purposes of this comment letter, we believe that Jump$tart Coalition's ("Jump$tart") National Standards for Personal Finance Education in secondary schools serve as a useful guide for defining financial literacy. Jump$tart is a national nonprofit organization which promotes financial literacy for high school and college students and offers guidelines for teaching key personal finance concepts, breaking out financial literacy into six areas, the one of direct interest here being 'Savings and Investments.' The Savings and Investments section includes six standards addressing:

- how saving contributes to financial well-being
- how investing builds wealth and helps meet financial goals
- evaluating investment alternatives
- buying and selling investments
- how taxes affect the rate of return on investments; and
- how agencies regulate financial markets to protect investors[3]

These standards generally reflect the activities covered by the SEC's authority. Other areas of financial literacy addressed by the national guidelines – such as insurance and credit – would appear to come under the jurisdiction of other regulators, such as state insurance commissioners and federal and state banking authorities.

Thus, when discussing the financial literacy needs of investors, we limit our comments to the financial literacy topics covered in Jump$tart's educational standards for 'Savings and Investments,' and recommend that, for purposes of its study, the Commission develop a definition based on the financial literacy skills needed to save and invest for retirement, college, and in meeting other investment-related individual or household goals.

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[2] See, e.g. "Financial Literacy Definition," National Financial Educators Council, http://www.financialeducatorscouncil.org/financial-literacy-definition.html (last visited March 2012).

[3] Jump$tart's standards are widely used by state secondary education systems around the country, and are often embedded in the curriculum of the 25 states that have initiated such programs. For more information, see "National Standards in K-12 Personal Finance Education," Jump$tart Coalition, http://www.jumpstart.org/national-standards.html (last visited March 2012).

Financial Literacy Rates Today

When the current state of financial literacy in the United States is examined, numerous studies confirm that most individuals cannot perform simple economic calculations and that they lack knowledge of basic financial concepts. With respect to investing, there are knowledge deficiencies regarding the importance of compound interest and the basics of risk diversification. Knowledge of more complex concepts, such as the difference between bonds and stocks, the operation of mutual funds, and basic asset pricing is even scarcer.[4] American adults' opinion of their own knowledge of basic financial concepts is low, with 41 percent last year giving themselves a grade of C, D, or F.[5] Other surveys illustrate the negative impact of this knowledge gap, such as basic market-timing mistakes where investors buy at the peak of the market and, after panic sets in, selling at a loss.[6]

Finally, studies have shown with respect to the selection of financial intermediaries – including consumer focus group sessions conducted on behalf of the Commission -- investors have a widely held, but mistaken, belief that advisors are required to act in their best interests. A 2010 survey by consumer and advisor groups reinforces this finding, indicating that two out of three U.S. investors believe stockbrokers are held to a fiduciary standard of care, and three out of five believe insurance agents have a similar duty.[7]

One might make a rough comparison of financial literacy today to the overall literacy rate of Americans in the early 19th century. Up until the 1870s, a sizeable part of the population was illiterate. In executing wills, getting married, or purchasing land, many simply made their 'mark,' usually an X, on legal instruments. They had no choice but to trust that the drafters of

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[4] *See,* e.g. Annamaria Lusardi, "Financial Literacy: An Essential Tool for Informed Consumer Choice?" (Dartmouth College, Harvard Business School, and NBER), June 2008, http://www.dartmouth.edu/~alusardi/Papers/Lusardi_Informed_Consumer.pdf (last visited March 2012).

[5] The National Foundation for Credit Counseling, March 2011 survey, http://www.nfcc.org/newsroom/FinancialLiteracy/files2011/NFCC_2011Financial%20LiteracySurvey_FINALREPORT_033011.pdf (last visited March 2012).

[6] *See*, e.g., David, F. Swensen, "The Mutual Fund Merry-Go-Round," *New York Times*, Aug. 14, 2011, page SR 6, http://www.nytimes.com/2011/08/14/opinion/sunday/the-mutual-fund-merry-go-round.html?_r=2&pagewanted=1 (last visited March 2012).

[7] Consumer Federation of America, et al., "U.S. Investors & The Fiduciary Standard: A National Opinion Survey," September 15, 2010, http://www.hastingsgroup.com/fiduciarysurvey/docs/091510%20Fiduciary%20survey%20report%20FINAL2.pdf (last visited March 2012); *see also* Angela A. Hung, et al., "Investor and Industry Perspectives on Investment Advisers and Broker-Dealers," RAND Institute for Civil Justice, Feb. 22, 2008 (Sponsored by the United States Securities and Exchange Commission), http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (last visited March 2012).

these documents essentially fulfilled a fiduciary duty by acting in their interest and with due care.

Today, we have an analogous situation. Although the vast majority of Americans can read and write, they are financially illiterate. They do not always fully understand the disclosures that they receive or the impact of the agreements they sign in connection with investment services or products offered. If they work with a financial intermediary, they must place their implicit trust and confidence in the advisor. Unlike the 19th century drafter of legal instruments, however, in many instances today the same financial advisor may dispense conflicted advice, contrary to the investor's expectations. Depending upon the law covering their activities, the financial intermediary may or may not have to disclose or manage these conflicts to the exclusive benefit of the client.

In summary, given the current regulatory environment in which investors lack the most basic skills for making sound investment decisions, and financial intermediaries may offer conflicted advice, it is incumbent upon the SEC to require disclosures in language of the most fundamental and direct nature. We cite disclosure examples in the comments that follow where we believe the current approach by the Commission could be greatly improved.

Disclosure Timing

The timing of disclosure requirements varies widely, sometimes even for the same activity but under different laws. In general, mutual fund prospectuses must be delivered and acknowledged in advance of purchase. The timing for delivery and updating of Form ADV are specified in the general instructions for the Brochure Rule.[8] Disclosure of conflicts involving principal transactions must be delivered in advance to fiduciary account holders, but not under suitability rules for brokerage accounts.

In general, we have two observations to make with respect to timing of disclosures, both in connection with financial intermediaries. First, we note the importance that the Commission attaches to affirmative and time-sensitive disclosures by investment fiduciaries, no matter if previous written disclosure was delivered in accordance with SEC rules.

For example, the general instructions to Part 2 of Form ADV state if the investment advisor believes, or has reasonable grounds to believe, that the client is not sufficiently informed of a material issue, then "sufficiently specific facts" are required so that the client can give informed consent to a recommendation.[9] It is our impression, however, that many financial intermediaries believe that once a client signs acknowledgement of written or electronic delivery they have fulfilled their disclosure requirements. This may not always be true. Thus,

[8] Rule 204-3 of the Advisers Act.

[9] Form ADV (Paper Version), General Instructions for Part 2 of Form ADV, 1-2, http://www.sec.gov/about/forms/formadv-part2.pdf (last visited March 2012).

we encourage the Commission to place even greater emphasis, when an intermediary is acting in a position of trust and confidence, on the duties of loyalty and care to document the timely disclosure of conflicts that are, or should be, provided to clients at the time specific services are provided.

At a time when the Commission is mindful of limited resources and investors are overwhelmed with disclosures, we do not believe new rules are needed. Files of client communications are already a part of advisors' existing books and records requirements. The SEC can stress the importance of this duty to document disclosure procedures through guidance, in deficiency letters, after sweeps that identify systemic problems, and by emphasizing fiduciary breaches in enforcement actions.

The second part of our comments on timing is in regard to the age and emotional state of the recipient at the time disclosure is made. It is well-known that investors are usually motivated to engage financial intermediaries after a major life change, i.e., marriage, beginning a family, divorce, or receipt of an inheritance. In terms of divorce or loss of close family members, where the investor may not be mentally prepared to make a rational and informed decision and is most vulnerable to conflicted advice, then the timing elements required by regulation are of no consequence. It is at this point that we believe the importance of a fiduciary duty of care and loyalty can be of utmost value, and therefore should be heavily emphasized by regulators.

Similarly, with regard to older investors, one recent study suggests that their ability to understand basic money concepts declines steadily after age 60, even as their confidence to make such decisions increases.[10] These ingredients combine to pose an increased threat to investor protection. Thus, we believe that the Commission should, through its educational materials and in CCO communications, etc., strongly emphasize a fiduciary duty of due care in recognizing timing issues unique to certain clients.

<u>Disclosure Content of Products and Services.</u>

<u>Products.</u>

Balance the Promotion of Returns with Risk. While there is no commonly accepted definition or measure of risk in investing,[11] nearly all experts agree that expected investment returns should be commensurate with risk. Given the negative connotations to the term 'risk,' it is understandable that the securities and mutual fund industry are prone to elevating the reward

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[10] "Does Our Financial Savvy Decrease with Age?" *Wall Street Fraud* blog (Nov. 11, 2011) http://wallstreetfraudblog.com/715/does-our-financial-savvy-decrease-with-age/ (last visited March 2012)

[11] *See,* e.g., Victor Ricciardi, "A Risk Perception Primer: A Narrative Research Review of the Risk Perception Literature in Behavioral Accounting and Behavioral Finance," July 21, 2004, 3, http://www.er.ethz.ch/teaching/Risk_perceptionPrimer.pdf (last visited March 2012).

part of the equation in their advertisements. We submit, however, that to promote financial literacy, disclosures by the industry should seek to balance discussions of returns with the risk involved, as discussed further below.

Advertisements. The SEC and FINRA currently allow great latitude in the marketing and promotion of investment products, absent misleading use of performance data. For example, mutual fund companies are allowed to promote 1 or 3-year returns that earn high Morningstar ratings, with only a brief disclaimer about historical results not being an indicator of future performance. The Commission can strengthen investor protection in advertising by objectively measuring advertising bias through the use of content analysis. If academic studies have not already been performed using this methodology, then the Commission may want to consider sponsoring a comprehensive study. Studies of fund manager performance clearly show that most funds at some point underperform the broad market. Informed by the use of objective analysis, then, the SEC should require balanced advertising with respect to performance returns and risk.

Very few mutual funds, for example, manage to repeat top-half or top-quartile performance consistently. For the five years ending in September 2011, according to the S&P Persistence Score Card, only 9.72% of large-cap funds, 6.08% of mid-cap funds and 3.27% of small-cap funds maintained a top-half ranking over five consecutive 12-month periods. Random expectations would suggest a rate of 6.25%. The results were even worse for longer-term performance.[12] Thus, the generic fund disclaimer that "past performance is not an indicator of future returns" is an extremely weak and insufficient warning of the risk assumed by the financially illiterate investor.

Just as the Federal Drug Administration requires pharmaceutical companies to disclose the side effects of a new product, so, too, should the SEC require mutual fund and other investment product vendors to disclose the potential side effects (i.e. risks) associated with short-term investment performance, as well as the long-term impact of costs and fees on investor returns.

Prospectuses. With respect to fund prospectuses, disclosures should be drafted in basic language that a high school senior can understand. The Commission should also consider creative ways of developing ratings designed to illustrate the risks of an investment product that are often buried in the narrative. Currently the legalistic and often dense thicket of disclosure language used in mutual fund prospectuses appears designed to reduce corporate liability rather than promote informed decision-making by retail shareholders. We cannot emphasize how important it is to keep disclosure <u>short</u> and <u>simple</u>. As noted earlier, over-disclosure is an endemic problem that years ago reached the point of becoming a deterrent rather than an aid to helping investors make smart financial decisions.

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[12] "Does Past Performance Matter?" *S&P Indices,* (November 2011), http://www.spindices.com/assets/files/portal/PersistenceScorecard_Nov2011_Final.pdf (last visited March 2012).

Risk-Related Warning Labels. There may be benefits in reviewing the abbreviated warning systems used by other federal agencies with respect to risk, although a simple disclaimer about future performance, as noted previously, may be insufficient.

In other situations where the hazard of a product is tangible and immediate, such as flammable materials, rating systems appear to work well. For example, the Hazardous Materials Information System ("HMIS") is a numerical hazard rating that incorporates the use of labels with color-coded bars. It was developed by the National Paint & Coatings Association as a compliance aid to rules of the Occupation, Safety and Health Administration. Among the standards associated with the HMIS, perhaps the most recognizable are the numeric values 0 to 4 used to rate fire hazards (with 0 being no risk, e.g. water, and 4 being the highest, e.g. propane, which may ignite spontaneously when mixed with oxygen). Similarly, equities may exhibit higher volatility on average than other investments over long-term market cycles; these could be coded to reflect this measurable difference in standard deviation or in other ways.

Reliance on numeric or other ratings alone, of course, carry their own unique problems when the hazards are less obvious. Morningstar is well-known for its mutual fund 'star' ratings assessing performance, and has been criticized for this simplistic approach. The value of these ratings is indeed limited unless each investment option is considered within a broad asset allocation. To its credit, Morningstar over the years has refined its star ratings to compare to benchmarks, such as a specific asset class, and not to the overall market. It also has developed a simple color-coded bar system for its investor subscription service in rating the risk and return of mutual funds. Nonetheless, star and color-coded ratings may confuse investors regarding risk-reward if each investment option is treated separately as a stand-alone product and not part of a diversified portfolio.

Greater Emphasis on Investment Expenses. Academic studies and financial regulators are well aware of the drag on long-term shareholder returns caused by mutual fund expenses. The SEC has for many years included information on the impact of fund expenses in the investor section of its web site.[13] One academic study suggests that mutual fund investors are more sensitive today to front-end loads, but that operating expenses are less salient to them, particularly during periods of market volatility.[14] Still, we believe that the SEC should do more than passively list information on its web site, but rather balance advertisements about investment returns with the impact of fund or other load expenses. With regard to mutual funds, this information should not be limited to loads and operating expenses, but also include portfolio

[13] *See,* e.g., "Mutual Fund Investing: Look at More Than a Fund's Past Performance SEC," SEC web site, May 8, 2007, http://www.sec.gov/investor/pubs/mfperform.htm (last visited March 2012).

[14] Brad M. Barber, et al., "Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows," *Journal of Business* (2005): Vol. 78, no. 6, 2098, http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/Out%20of%20Signt.pdf (last visited March 2012).

transaction costs, soft dollar expenses, 12b-1 and other fees that are scattered across other disclosure documents.

Even though some reports indicate the expense ratios of mutual funds with the most assets in qualified plans are much lower than other funds' costs,[15] the U.S. Department of Labor has been at the forefront in attempting to provide better disclosure of other expenses associated with plan assets. Recently it adopted a new rule to require full disclosure of costs and compensation received by services providers to a qualified plan.[16] Inasmuch as many advisors (who are service providers to ERISA plans) are also investment fiduciaries to retail clients, we believe the SEC should place equal emphasis on the fiduciary duty of advisors to disclose all expenses and make diligent efforts to maintain and benchmark costs associated with investment products and services.

Greater Emphasis on Diversification. Finally, diversification is a well-known and widely accepted tenet of Modern Portfolio Theory. Its principal use is as a way for investors to earn the same expected rate of return with less risk.[17] While investment experts may debate the most efficient method of modeling risk and return, diversification is an easy concept for even the novice investor to understand. Yet studies show that, notwithstanding losses from the tech bubble and Enron, some investors continue to concentrate a large portion of their assets in sectors or company stock.[18]

Company stock is perhaps the most cited example, but it's not the only problem. Style drift in mutual funds or sector bets can also reduce the benefits of diversification. The Commission should consider standard notices in industry advertisements, and where appropriate, messaging on its web site, to identify style drift as a potential problem in emphasizing the importance of diversification.

Indeed, the prudent investment requirements for fiduciaries under the Employee Retirement Income Security Act of 1974 require plan sponsors to offer a reasonable selection of diversified investment options. Over the years Congress has made additional changes to qualified plans, such as encouraging diversification in ESOPs and limits on mandatory contributions of company

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[15] "Division of Investment Management: Report on Mutual Fund Fees and Expenses," SEC, December 2000, http://www.sec.gov/news/studies/feestudy.htm (last visited March 2012).

[16] "Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure," Employee Benefits Security Administration, 29 CFR Part 2550, Feb. 3, 2012, http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=25781 (last visited March 2012).

[17] *See*, e.g., Burton Malkiel, *A Random Walk Down Wall Street* (New York: W.W. Norton & Company, 2011 ed.) 216-219.

[18] *See,* e.g. Alex Brill, "The Case Against Company Stock in 401(k)," *Retirement Policy Outlook,* American Enterprise Institute, Apr. 28, 2011, http://www.aei.org/article/economics/fiscal-policy/taxes/the-case-against-company-stock-in-401ks/ (last visited March 2012).

stock in defined contribution plans. The SEC likewise should consider placing more emphasis on the benefits of diversification in its educational resources and require FINRA to take similar actions in reviewing advertising literature.

Disclosure Formats. Given the seemingly endless stream of disclosures that consumers receive from financial institutions, and their inclination to ignore the material disclosures that may be buried within a prospectus, the SEC should accordingly place more emphasis on summary disclosures with templates that allow investors to make appropriate comparisons between similar products or services.

With respect to mutual funds, much of the information on expenses and conflicts needed by investors remains scattered and sometimes difficult to access. Although the prospectus will provide an overall expense ratio, it does not include the Statement of Additional Information on commission, related portfolio transaction, and soft dollar costs. Some fund complexes may post this information online, but they are not required to do so. Consolidating these critical pieces of information in a central, easily accessible location on a fund's web page or in the prospectus would be extremely helpful to mutual fund investors.

Intermediary Services.

Helping educate investors on the function of agencies regulating financial markets is consistent with Jump$tart's sixth standard under the 'Savings and Investments' category, previously described above. Given the SEC's central role in overseeing the securities markets, we believe the agency's educational resources devoted to financial literacy should address one of the current policy debates that affect investors - that is, the appropriate standard for personalized investment advice. However, finding relevant information on the differences between suitability and fiduciary standards for advice-givers and the varying degrees to which conflicts of interest are disclosed, is noticeably absent in the SEC's Investor.gov website and elsewhere.

Some financial advisors are held to a fiduciary standard under securities laws but hundreds of thousands are not. Unlike other professionals, such as doctors, lawyers and accountants, financial intermediaries may have agency relationships with a principal that leads to inherent conflicts in the customer relationship. Moreover, selection of a financial intermediary is important with respect to high net worth households that hold the bulk of personal wealth in this country and tend to be more likely to seek professional advice. Exacerbating the problem of identifying the characteristics of a trusted advisor is the lack of regulatory restrictions on job titles used in the financial services industry.[19] We cite examples below where a discussion or linking of the accountability standards for intermediaries to disclosure are absent.

[19] *See,* e.g., Arthur Laby, "Reforming the Regulation of Broker-Dealers and Investment Advisers," *The Business Lawyer* (February 2010): Vol. 65, 404, http://media.oregonlive.com/finance/other/ssrn-id1491268(2).pdf (last visited March 2012).

In selecting a financial intermediary, for example, the availability of disciplinary information and other qualifications online at the Investment Adviser Public Disclosure ("IAPD") site or FINRA's BrokerCheck has seemingly made it easier for an investor to shop and compare. However, there is at least one loophole that impedes the investor's ability to access important disciplinary disclosures. While disciplinary events are required to be reported on the individual adviser agent's Brochure Supplement, SEC staff interprets the insertion of a link to BrokerCheck or IAPD to satisfy delivery requirements if the supplement is delivered electronically.[20] Taken together with a separate study sponsored by FINRA's education foundation that only 15 percent of investors who searched for an advisor also checked with a state or federal regulator regarding the advisor's credentials or background, it seems that adding another disclosure step to the search process would be counter-productive.[21]

Another example of where little effort was made in distinguishing clearly between the two regimens is the disclosure statement for fee-based brokerage services under Rule 202(a)(11)-1, which was later vacated by a federal appeals court for other reasons.[22]

Under the vacated rule, the summary disclosure would have been required to be delivered prior to executing a fee-based brokerage agreement. However, it was silent on a timing requirement, meaning the disclosure could be made at the same time the account agreement was executed, leaving little time for review. With respect to the disclosure document, the template actually would have *reversed* the disclosure burden and shifted it to the investor by encouraging him or her to ask questions regarding the extent that disclosures of conflicts are actually made. In addition, the summary disclosure was opaque and noted only that the broker's compensation "may vary" and may be "based on what you buy," without stating directly that the broker may receive financial incentives in recommending certain products over others. Importantly, the disclosure also neglectedthe fiduciary issue by placing the burden on the customer to ask about the extent to which the broker is obligated to act in the customer's best interest.

The disclosure summary in the vacated rule follows:

> "Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are

[20] "Staff Responses to Questions about Part 2 of Form ADV," SEC web site, Question VI.2, http://www.sec.gov/divisions/investment/form-adv-part-2-faq.htm (last visited March 2012).

[21] *See* "Financial Capability in the United States," FINRA Investor Education Foundation, Dec. 1, 2009, 46, http://www.finrafoundation.org/web/groups/foundation/@foundation/documents/foundation/p120536.pdf (last visited March 2012).

[22] Fin. Planning Ass'n v. SEC, 482 F.3d 481, 486 n.5 (D.C. Cir. 2007).

> paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time." [23]

A subsequent investigative story by a consumer writer revealed some of the evasive techniques used by fee-based brokers to avoid disclosing the true nature of the conflicts under the disclosure requirement and confirming that, at least anecdotally, that opacity and oblique references to conflicts of interest in a boilerplate disclosure do not always work.

> [O]ur experience showed that in their new roles, many brokers seemed just as confused as their customers. We met would-be shepherds who ranged from the reassuringly authoritative to the disconcertingly green. We got contradictory advice that varied from the wise to the way off. We found out that a high proportion of our advisers couldn't explain what "fiduciary duty" was. And while some firms disagree with our interpretation of the [disclosure] rules, five brokerages made promises that seemed to violate one key regulation. The good news: We picked up a lot of attractive graphs and pie charts, and a couple weeks' worth of free coffee. [24]

In our third example of incomplete investor information, we have reviewed the Investor.gov site. The Commission should be commended on the many practical tools and plain-English descriptions of investment products, among other things, that are available on the website. Anecdotally, we know professional advisors that have sent clients to the site for additional educational information and consider it to be eminently useful.

However, in its review of the differences between brokers and investment advisors, Investor.gov makes no reference to a fiduciary and a suitability standard, or examples of the different conflicts of interest that might arise in working with either kind of agent (or under both standards for the 275,000 dually registered agents).[25] In light of the 2007 RAND report highlighting investor confusion in standards that apply to advisors, and the recommendation of the SEC staff in the Dodd-Frank Section 913 report[26] to establish a uniform fiduciary standard for brokers and investment advisors, we believe that the Commission should make a more concerted effort to educate investors on this critical area of investor protection. Reasons for the need for greater investor education in this area are detailed below.

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[23] SEC rule 202(a)(11)-1, "Certain Broker-Dealers Deemed Not To Be Investment Advisers," http://www.sec.gov/rules/final/34-51523.pdf (last visited March 2012).

[24] Dyan Machan, "The New Broker Game," *SmartMoney,* Apr.1, 2007.

[25] *See*, et al., "Working with Brokers and Advisers," http://investor.gov/researching-managing-investments/working-brokers-investment-advisers (last visited March 2012).

[26] *See* "Study on Investment Advisers and Broker-Dealers," SEC staff report, ii, January 2011.

Differentiating Between Brokers and Investment Advisors. When selecting a financial intermediary, investors are faced with a wide array of confusing and often perplexing choices in the range of products offered, qualifications of the advisor, and the market conduct standards to which advisors are held accountable. The same individual advisor may even wear several different regulatory hats when advising a client.[27] For example, a financial planner who is licensed as an insurance producer has no suitability requirement in selling life insurance, and only in some states is required to recommend fixed annuities that are suitable to the customer's needs. Registered representatives of broker-dealers providing investment advice have common-law fiduciary requirements for non-discretionary accounts in only four states,[28] and suitability standard requirements under FINRA rules in all 50. Investment advisors on the state and federal level are held to a significantly higher fiduciary standard of conduct for their investment advice. In short, it should be obvious that investors face daunting challenges if their goal is to hire a financial advisor who will legally act in their best interest.

Fiduciary Duty to Affirmatively Disclose. If the Commission moves forward in adopting a uniform fiduciary duty for brokers and advisors, we believe that it could avoid much of the costs and associated problems of over-disclosure with new rules by emphasizing the fiduciary duty of loyalty through regulatory guidance. As noted previously, under the duties of loyalty and care, the fiduciary advisor is required to provide the client with sufficient information, whether written or verbal, to ensure that he or she is able to make an informed decision.

Conclusion

Understanding the current financial literacy of investors is critical to harmonizing and improving the effectiveness of disclosure under current SEC rules and ultimately, to strengthen investor protection. We truly appreciate the opportunity to provide some general observations on this important issue. Please do not hesitate to contact us at (412) 221-0292 if you have any questions.

Sincerely,

Blaine F. Aikin
CEO

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[27] Additional details on varying standards and regulatory gaps for financial advisors can be found in the GAO's report under Sec. 919c of the Dodd-Frank Act, "Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain," January 2011.

[28] Michael S. Finke and Thomas Patrick Langdon, "The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice," March 9, 2012 http://ssrn.com/abstract=2019090 (last visited March 2012).

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