INVESTMENT COMPANY INSTITUTE

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March 23, 2012

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

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

Dear Ms. Murphy:

The Investment Company Institute ("ICI" or "the Institute")[1] appreciates the opportunity to offer its views on certain issues the Commission must address as part of the financial literacy study required by Section 917 of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010.[2]

As indicated in the Comment Request, several components of the study specifically reference mutual funds. It bears noting that mutual funds stand out among retail investment products with respect to the amount of information available to investors, both before buying and as owners of mutual fund shares, as well as the detailed regulations surrounding mutual fund disclosure and advertising, which seek to ensure that such information is accurate and not misleading.

The Institute has a longstanding history of supporting initiatives to improve the quality of information investors receive about mutual funds in a variety of distribution channels.[3] In addition, the

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.98 trillion and serve over 90 million shareholders.

[2] *See Comment Request for Study Regarding Financial Literacy Among Investors,* SEC Release No. 34-66164 (Jan. 17, 2012), 77 Fed. Reg. 3294 (Jan. 23, 2012) ("Comment Request").

[3] *See, e.g.,* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Nancy Morris, Secretary, U.S. Securities and Exchange Commission, dated Feb. 28, 2008 (supporting the SEC's mutual fund summary prospectus proposal); *ICI Proposes Disclosure Principles for Target Date Funds*, June 18, 2009, available at

Institute has long supported disclosure initiatives to provide investors meaningful information about conflicts of interest that might impact a broker-dealer's recommendation of an investment product or service, as well as the costs associated with purchasing products or services through a broker-dealer.[4] We continue to support a holistic, well-considered, and thorough approach to all such disclosures and are pleased that, in connection with its study, the Commission is soliciting information regarding disclosures associated with the variety of investment products and services that are sold or offered to retail investors.

We offer the following comments on the issues listed in the Comment Request.

I. Methods to improve the timing, content, and format of disclosures to investors with respect to financial intermediaries, investment products, and investment services

a. Methods to Improve the Timing of Disclosure

ICI has long supported improving disclosures that may help investors assess and evaluate a broker-dealer's recommendation of an investment product or service.[5] As discussed in more detail below in Section II.a., such disclosures help to inform investors and potential investors of the products and services offered by a financial intermediary, the compensation an intermediary may receive, and any potential conflicts of interest it may have in connection with the offer or sale of particular investment products or services. Our support for the concept of enhanced disclosure at or before the point of sale, however, is subject to two overarching caveats.

First, the Institute has consistently expressed concern about the possibility of limiting any point of sale disclosure requirement to the sale of mutual funds.[6] We believe such an approach would at best

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http://www.ici.org/trdf/news_releases/09_news_target_fund; *ICI Policy Statement: Retirement Plan Disclosure,* January 30, 2007, available at http://www.ici.org/pdf/ppr_07_ret_disclosure_stmt.pdf.

[4] *See, e.g.,* Letter from Karrie McMillan, General Counsel, ICI, to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated Aug. 3, 2009; Letter from Craig S. Tyle, General Counsel, ICI, to Joan C. Conley, Office of the Corporate Secretary, NASD Regulation, Inc., dated Oct. 15, 1997; Letter from Craig S. Tyle, General Counsel, ICI, to Annette L. Nazareth, Director, Division of Market Regulation, and Paul F. Roye, Director, Division of Investment Management, Securities and Exchange Commission, dated May 8, 2000; and Letter from Craig S. Tyle, General Counsel, ICI, to Barbara Z. Sweeney, Office of the Corporate Secretary, NASD Regulation, Inc., dated October 17, 2003.

[5] *Id.*

[6] *See* Testimony of Paul Schott Stevens, President and CEO, ICI, Before the Committee on Financial Services, United States House of Representatives, on "Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals," July 17, 2009, available at http://www.ici.org/policy/ici_testimony/09_reg_reform_jul_tmny. *See also* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated May 31, 2011; Letter from Karrie McMillan, dated Aug. 3, 2009, *supra* note 4; Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Mr. Jonathan Katz, Secretary, U.S. Securities and Exchange Commission, dated Apr. 4, 2005.

provide incomplete investor protection and may in practice disserve investors. Imposing point of sale obligations only on the offer or sale of mutual funds could create strong incentives for broker-dealers and other financial intermediaries to recommend investment products not subject to the same regulatory burdens, such as variable annuity contracts, collective investment trusts, and separate accounts, even when those products do not offer the same level of regulatory protection and other benefits for investors.

Regulators and consumer advocates alike have expressed concerns about this likely result. Former NASD Chairman Robert Glauber, for example, has stressed the need to consider this consequence, explaining that "an investor should be sold a security because it's right for him or her, not because it's easier to sell than something else."[7] Similarly, Barbara Roper of the Consumer Federation of America stated that by considering certain fee disclosures as "a mutual fund issue, instead of a broker compensation issue, sort of more holistically, you run the risk that you make mutual funds less attractive to sell. And I think that would be a very bad thing."[8]

To avoid these adverse consequences, any point of sale disclosure obligation should be product-neutral. The policy goals underlying point of sale disclosure – assuring that investors understand the investment and the compensation arrangements of those recommending the investment – are no less valid for other types of investments. If investors would benefit from receiving such information during the sales process, the information should be required for all retail investment products, not just mutual funds.

Our second overarching concern is that any point of sale disclosure requirement must be designed to minimize disruptions to the sales process. Investment sales typically occur over the Internet or by telephone, rather than through face-to-face meetings, so requiring the physical transfer of a disclosure document is not realistic. Any point of sale disclosure requirement should recognize this reality, and should provide investors with timely and convenient access to the required information without impeding their ability to conduct transactions or imposing inappropriate costs and burdens on intermediaries. As discussed further below in Section I.c., widespread use of the Internet by investors, coupled with advances in technology, make electronic delivery the ideal medium for such disclosure.

Relatedly, any required disclosure must be appropriately tailored to fit the type of financial intermediary providing the disclosure, as well as its relationship with customers. For example, full service broker-dealers that interact directly with retail customers and provide a variety of products and services should have more extensive disclosure obligations than those that conduct a more limited

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[7] *See* Remarks by Robert Glauber, Chairman, NASD, at the ICI's 2006 General Membership Meeting (May 18, 2006), available at http://www.finra.org/PressRoom/SpeechesTestimony/RobertR.Glauber/p016642.

[8] *See* Remarks by Barbara Roper, Director of Investor Protection, Consumer Federation of America, at the Securities and Exchange Commission 12b-1 Roundtable, Unofficial Transcript, p. 196, available at http://www.sec.gov/news/openmeetings/2007/12b1transcript-061907.pdf.

business.[9] Further, these disclosure requirements and the related delivery requirements should relate to the nature of the investor's transaction. So, for example, disclosure may not be necessary for an investor purchasing additional shares of a security he or she currently owns, or to an investor effecting an unsolicited transaction.

b. Methods to Improve the Content of Disclosure

A number of considerations can help to improve the content of disclosure. First, it is critical to tailor the disclosure to its intended purpose: *e.g.,* to educate investors about a financial intermediary and its services and operations, or about an investment product. For example, information intended to educate investors about a broker-dealer might include such topics as: the nature of the broker-dealer's business model, what products and services it offers, how it is compensated, and any potential conflicts of interest it may have. Information intended to educate investors about an investment product might include the type of information currently provided to investors in a mutual fund's summary prospectus, as discussed in more detail below in Section III.[10]

Second, effective investor research can dramatically strengthen the quality of disclosure rulemaking. The Commission's recent experience with the mutual fund summary prospectus may provide a helpful blueprint for any approach to improving the content of disclosures with respect to investment products and services. Prior to adopting the summary prospectus, the Commission and others conducted in-depth investor research to establish the most important information for investors to receive.[11] The Commission's approach of focusing on the essential information, while making additional information available to those who desire it, results in better-informed investors because they are more likely to read concise, well-designed disclosure. Advances in technology have made this "layering approach" to disclosure feasible, enabling investors to focus on the information that is of interest to them.

We recommend that the SEC use the summary prospectus as a model for product-specific disclosure for *all* investment products and services sold to retail investors. More specifically, the Commission should assess, for each such product and service, the essential information that should be

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[9] Indeed, we believe it is appropriate to exclude certain broker-dealers, such as mutual fund underwriters, from disclosure requirements if the disclosure would not be meaningful to the broker-dealer's customers based on the nature of the broker-dealer's operations and the services it provides. *See* Letter from Tamara K. Salmon, Senior Associate Counsel, ICI, to Ms. Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated Dec. 24, 2010.

[10] As discussed in detail below in Section III, placing the disclosure obligation on the appropriate party makes it possible for investors to receive more targeted information; conversely, a failure to do so may result in practical challenges and less effective disclosure.

[11] *See* Letter from Karrie McMillan dated Feb. 28, 2008, *supra* note 3, at n. 9 (detailing the empirical research conducted by the SEC, the ICI, and others on the contents and benefits of streamlined disclosure of essential fund information).

made available to retail investors, and then require that such information be made available in a concise, well-designed, easy to understand, and standardized format, with additional information made available to those who seek it. As with information included in a mutual fund's summary prospectus, this information is likely to include, at a minimum, the investment product or service's objectives, strategies, risks, fees, and expenses, as well as how to purchase (and sell, if applicable) the product or service; such a disclosure should also tell investors where they can find additional information should they desire it.

c. Methods to Improve the Format of Disclosures

As noted above, we believe that disclosures should be concise, well-designed, easy to understand, and in a standardized format. Additionally, the Commission should focus on the delivery mechanism for disclosure, and in particular should consider electronic formats. In 2008 we supported the Commission's approach of providing the mutual fund summary prospectus to investors in paper, unless the investor opted for electronic delivery. At the time we noted that, over time, we expected investors to become accustomed to seeking investment information on the Internet, and recommended that the Commission revisit whether provision of information solely on the Internet may be sufficient.[12] With over 90 percent of mutual fund-owning households having access to the Internet, and 84 percent reporting that they go online for financial purposes, we believe the time has come to move to the Internet as the primary medium for financial product disclosure.[13]

Using the Internet as the primary vehicle for providing information to investors will help to address many of the concerns we have raised about previous point of sale disclosure initiatives. For example, we have expressed concern that requiring certain information to be physically provided to an investor immediately before entering into a transaction (*e.g.,* by handing or faxing a paper document), could be extremely disruptive to the sales process.[14] The continuous availability of information disseminated via the Internet addresses this concern and enables investors to review the information as and when they want to and not under the pressure of effecting a transaction. We have also previously stressed that the costs to financial intermediaries of providing any required point of sale -disclosure

[12] *Id.* at n. 3.

[13] ICI, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2011,* Research Perspective, Vol. 17, No. 5, Oct. 2011, available at http://www.ici.org/pdf/per17-05.pdf. *See also* Peter P. Swire and Kenesa Ahmed, *Delivering ERISA Disclosure for Defined Contribution Plans: Why the Time Has Come to Prefer Electronic Delivery* (June 2011), available at: http://www.ici.org/pdf/ppr_11_disclosure_dc.pdf.

[14] To the extent such a requirement applies only to the sale of certain types of investment products, we believe it could also create incentives for financial intermediaries to sell products not subject to such regulatory burdens.

should not outweigh its benefit to investors.[15] Delivery of information through electronic media substantially reduces the costs of disclosure, including any requirements to update such disclosure.[16]

Finally, a shift to electronic media can have a substantial impact on its quality. The Internet offers a vehicle for providing investors with exactly the amount of information they want, whenever they want it. Attention to the delivery mechanism for investment information will improve the quality of disclosure by improving the ability of investors to access the information they seek.

II. The most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product or service that is typically sold to retail investors, including shares of registered open-end investment companies

a. Information Needed Before Engaging a Financial Intermediary

Financial intermediaries provide a valuable link between issuers and investors. Institute research indicates that, among investors owning mutual fund shares outside of retirement plans at work, 81 percent own fund shares through professional financial advisers.[17] These advisers are typically registered investment advisers, which are subject to the jurisdiction of either the SEC or the state in which they have clients; broker-dealers, which are regulated by both the SEC and FINRA; or insurance companies, which are subject exclusively to state regulation and therefore presumably not within the scope of the Commission's study.

The Institute continues to support disclosures that inform retail investors and potential investors of the products and services offered by financial intermediaries, as well as the conflicts of interest that may arise in connection with offering or recommending investment products or services to retail investors.[18] In general, we support regulatory initiatives to provide investors meaningful disclosure in a way that effectively addresses the many difficult operational and procedural challenges

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[15] *See* Letter from Tamara K. Salmon, *supra* note 9.

[16] As explained in the Institute's comment letter on the SEC's summary prospectus proposal, there are substantial costs and operational challenges associated with printing and delivering to investors a paper document that is updated on a quarterly basis. However, the performance information funds typically post on their websites is updated at least quarterly. *See* Letter from Karrie McMillan, dated February 28, 2008, *supra* note 3.

[17] ICI Fact Book (2011) available at http://www.icifactbook.org at 73.

[18] *See* Letter from Amy B.R. Lancellotta, Acting General Counsel, ICI, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 12, 2004; Letter from Elizabeth Krentzman, *supra* note 6, and Letter from Tamara K. Salmon, *supra* note 9.

that such new requirements would pose for broker-dealers.[19] As discussed above, electronic delivery could address many of these concerns.

Rule 204-3 under the Investment Advisers Act of 1940, the "Brochure Rule," requires investment advisers to provide each client or prospective client with a brochure describing the adviser's business practices, conflicts of interest, and the qualifications of the investment adviser and its advisory personnel. To the extent possible, the Commission should require broker-dealers to provide disclosures similar to those required under the Brochure Rule, when the substance of such disclosures is relevant to the broker-dealer's clients.

A broker-dealer "brochure" should provide customers and potential customers with relevant information about the broker-dealer including, for example: the types of brokerage accounts and services offered to customers; the scope of services provided; products offered; fees charged in connection with the various products and services offered; and the firm's and its representatives' financial incentives and potential conflicts of interests.[20] It should include information detailing the conflicts that may result from the cash compensation received by the broker-dealer for selling particular products as well as the differential payout rates paid to the individual representatives. These types of compensation arrangements could provide incentives to recommend one investment product or service over another or one issuer's product over another's. The greater the transparency of this compensation and related conflict information, the better informed the investor will be regarding the broker-dealer's recommendations when deciding among recommended products or services.[21]

To be most useful, the 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 at the time an account is opened or the customer commences a relationship with the broker-dealer. Also, like the delivery requirements associated with the Brochure Rule, broker-dealers should be required to deliver or offer to deliver a current copy of the document annually.[22] As we have explained previously, however, we urge that such a brochure – and the delivery requirements associated with it – be appropriately tailored to situations in which the

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[19] Letter from Elizabeth Krentzman, *supra* note 6.

[20] The document might also include a legend informing investors that additional information, including disciplinary information, about the broker-dealer or its registered representative who is handling the customer's account, is available via the public portion of the Central Registration Depository (CRD) system.

[21] We are pleased that FINRA recently proposed requiring its members to provide such a disclosure document to clients and potential clients of its members. *See Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship,* FINRA Regulatory Notice No. 10-54 (Oct. 2010).

[22] As noted above, electronic delivery should be the default means of delivery.

contemplated disclosure would be of value to investors, so that investors are provided with more meaningful – not just more voluminous – disclosure.[23]

b. Information Needed Before Purchasing an Investment Product or Service

In addition to information about financial intermediaries, investors and potential investors should be provided with key information about the product or service they are considering or buying. This information may vary based on the type of product or service, but at minimum will likely include, as applicable, its objectives, strategies, risks, fees, and expenses. As with the mutual fund summary prospectus, the specific content and order of required information should be prescribed to allow investors to compare similar products or services more easily. Additionally, to the extent possible, such content also should be similar *across* products, so that an investor can more easily understand the differences between various types of products and services. The summary prospectus is an excellent model of product disclosure that could be tailored to a variety of investment products to enable comparison of different products based on similar criteria and information.

III. Methods to increase the transparency of expenses and conflicts of interest in transactions involving investment services and products, including shares of mutual funds

A variety of fees and expenses may be charged to investors in connection with the sale of financial products or the provision of financial services. Such fees and expenses may be embedded within the product or service or assessed separately by a financial intermediary. Fees embedded within products may be unseen by or unknown to the investor unless expressly disclosed. Depending on the product these fees could include management fees and operating expenses, built-in sales charges, or a mark up or mark down. Separately assessed fees may include wrap fees, commissions, service fees, or account maintenance fees, among others. Conflicts of interest that a financial intermediary may face can be similarly complicated, and are another critical element for investors to understand. To improve the quality of disclosure in these areas, it is critical to recognize that intermediary disclosure and product disclosure are necessarily distinct, and to place the disclosure obligation on the appropriate party. A failure to do so may result in practical problems and less effective disclosure.[24]

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[23] *See* Letter from Tamara K. Salmon, *supra* note 9. We oppose requiring broker-dealers that do not conduct a retail brokerage business, such as mutual fund underwriters, to deliver such a document as it would not be meaningful to retail investors.

[24] For example, while we believe the mutual fund summary prospectus is an excellent example of product-specific disclosure that clearly depicts the fees embedded in a fund share (*i.e.,* management expenses, 12b-1 fees, and other expense, all of which are deducted from fund assets), by its nature the summary prospectus is limited in its ability to convey specific broker expense and conflict information. The summary prospectus is required to list the maximum sales charge (load) imposed on purchases; yet because the amount of the load an investor actual pays may differ based on the distribution channel and other factors, the fund's disclosure cannot accurately convey the specific cost to an individual investor. Similarly, funds that pay (or have related companies pay) certain financial intermediaries for the sale of fund shares or related services must disclose

To increase the transparency and clarity of disclosure regarding expenses and conflicts of interest, we recommend that the Commission carefully consider the appropriate source of disclosure for each of these elements. As discussed above, we believe the mutual fund summary prospectus is an excellent model for product-specific disclosure, which should be required of all investment products and services sold to retail investors. Form ADV provides information about fees charged to clients of investment advisers, and is an excellent model for disclosures regarding a broker-dealer's services.

We recommend that the Commission require broker-dealers to disclose any fees or expenses they charge for selling investment products or providing services to investors, and to describe any potential conflicts of interest that may cause them to recommend one investment product or service over another. To ensure that investors recognize that there may be different types of fees associated with their investment – *i.e.,* those charged by the mutual fund or other investment product and those charged by the broker-dealer – these disclosures could cross-reference one another. For example, the mutual fund summary prospectus already provides the maximum load a broker-dealer may charge and indicates that a broker-dealer may have a conflict of interest due to cash compensation; in both cases the summary prospectus refers the investor to his or her financial intermediary for more information. Similarly, a broker-dealer's disclosure might state, as applicable, that any fees charged are in addition to the fees or expenses of the product or service being sold, and refer the investor to the product-specific disclosure.

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this in their summary prospectus, and state that "these payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment." Because an investor may buy the fund from any number of intermediaries, however, the summary prospectus cannot accurately convey whether any specific intermediary is receiving such compensation.

ICI appreciates the opportunity to comment on this important study. If you have any questions, please contact me at 202/326-5815, Tami Salmon at 202/326-5825, or Mara Shreck at 202/326-5923.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

cc: Eileen Rominger, Director
Susan Nash, Associate Director
Division of Investment Management