



Testimony

Of

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Subcommittee on
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Mr. Chairman and Members of the Subcommittee: Thank you for inviting us to testify on financial literacy and for allowing us to submit this statement for the record. NASD is committed to expanding the knowledge and confidence of all Americans wishing to build a more secure financial future through saving and investing.

NASD

Founded in 1936, NASD is the private-sector securities regulator for the U.S. securities industry. In 1939, the SEC approved NASD's registration as a national securities association under authority granted by the 1938 Maloney Act Amendments to the Securities Exchange Act of 1934. We regulate every broker-dealer in the United States that conducts a securities business with the public—about 5,100 securities firms that operate more than 171,000 branch offices and employ nearly 660,000 registered representatives.

Our rules regulate every aspect of the brokerage business. Our market integrity and investor protection responsibilities include compliance examinations, rule writing, enforcement, professional training, licensing and registration, dispute resolution and investor education. NASD examines broker-dealers for compliance with NASD rules, MSRB rules and the federal securities laws, and we discipline those who fail to comply. Last year, NASD filed a record number of new enforcement actions (1,410) and barred or suspended more individuals (830) from the securities industry than in any previous year. We regulate trading on the NASDAQ Stock Market, the American Stock Exchange and the International Stock Exchange under contractual arrangements with those markets. NASD has a nationwide staff of more than 2,400 and is overseen by a Board of Governors, more than half of whom are not in the securities industry.

Executive Summary

My testimony today will focus on NASD's work in the area of investor education. NASD believes that educating investors is the first line of defense in protecting them. Our core mission of investor protection and market integrity is advanced greatly by having investors be more knowledgeable. We have issued educational materials to alert investors to potential problems and provide plain English explanations of products and processes. We have developed tools for investors to use in making financial decisions. We conduct public education events to reach out to investors. In addition to the investor education activities of NASD itself, the recently created NASD Investor Education Foundation supports innovative research and educational projects that give investors the tools they need to better understand the markets and the basic principles of saving and investing. The NASD Foundation has awarded more than \$4.8 million in grants for educational programs and research projects targeting underserved segments of the population. And as I previously testified before Congress recently, we launched efforts to educate military personnel and their families so that they are able to avoid fraudulent and inappropriate products and sales pitches and manage their money with confidence.

Tools for Investors

An overwhelming number of investors realize they need to be better informed about investing, and NASD has responded with a wide variety of resources. These include devoting a large segment of our Web site, www.nasd.com, to information useful to mainstream investors. We issue investor alerts and other publications, and we have an assortment of free Internet based tools to give investors the information they need to make informed investment decisions. Our materials cover information that can be valuable to all investors—those starting out, saving for a home, saving for a college education or contemplating or enjoying retirement. These groups each have different needs and NASD has resources available to help all of them, whether they are selecting an investment professional, comparing the fees and expenses of mutual funds, or choosing a college savings plan that's right for the investor.

NASD BrokerCheck

A critical first step when doing business with an investment professional is knowing about that person's or firm's background. NASD's BrokerCheck Program gives investors convenient access to information about brokerage firms and individual brokers. Like other NASD tools for retail investors, it is available free of charge. We encourage investors to use this valuable resource to learn about the disciplinary history, professional background, business practices and conduct of brokerage firms and brokers with whom they invest. Through the Web at www.nasdbrokercheck.com or a toll-free hotline (1-800-289-9999), investors may obtain employment and registration information and request a disclosure report. NASD obtains this information from brokers, NASD member firms, the SEC and state regulators as part of the securities industry's registration and licensing process.

BrokerCheck is not only an essential first step in selecting a broker or firm, but also a resource that individuals should use periodically to check on their broker or firm. BrokerCheck tells you the states in which brokers are registered to do business. It tells you their employment history and whether they have had any disciplinary problems, such as certain types of criminal actions, enforcement actions by NASD and other regulators, customer complaints and certain investor-initiated arbitrations.

We urge investors to use BrokerCheck to learn about their investment professionals BEFORE they invest. Investors can also contact their state securities department to obtain information about brokers. Each state has its own securities department that regulates the securities industry within its boundaries.

Professional Designation Database

The regulatory landscape can be confusing to investors. Depending on whether the professional they are dealing with is a broker-dealer, an insurance professional or a registered investment advisor, the rules that govern the relationship between the customer

and the person advising them differ. Moreover, in recent years, there has been a proliferation of certifications obtained by investment professionals that can be used to strengthen that person's credentials or, on the other hand, simply to enhance that person's apparent credibility. NASD's Professional Designation Database, http://apps.nasd.com/investor_information/resources/designations, is the only tool available to investors that helps them to sort through the list of professional designations and better understand what education and experience requirements are necessary for a designation. With this tool, investors can see whether the granting organization mandates continuing education, offers a public disciplinary process, provides a means to check a professional's status, offers a dispute mechanism and otherwise ensures that a professional designation is more than just a string of letters.

Mutual Fund Expense Analyzer

Many investors do not realize that the fees and expenses charged by mutual funds can make a big difference in the performance of their investment. With a data feed of expense data on virtually every mutual fund and exchange traded fund, the NASD Mutual Fund Expense Analyzer lets investors analyze the impact of fees and expenses on fund performance by showing how those fees add up over time. Investors can research one fund at a time, or can compare the costs of as many as three funds or classes of a single fund at a time. And the tool provides investors with a graph that shows not only the impact of time on their investment—but the impact of time on expenses, and how those expenses can affect an investment, particularly over the long term.

Bond Learning Center

The NASD Bond Learning Center covers all types of bonds, from savings bonds to municipals, treasuries and agency bonds, as well as information about bond funds. The Bond Center offers a risk report card for each bond category. It walks investors through how to buy and sell different types of bonds and provides some strategies for bond investing. For example, investors can learn about bond “laddering.” This involves spreading money among several different bonds with increasingly longer maturities—for example, a bond that matures in two years, one in four years and one in six years. Laddering is a way to minimize both interest rate risk and reinvestment risk, which is the risk that after a bond matures, the options for reinvesting that money aren't as favorable as when you first bought the bond. NASD strives to provide a balance of basic information and more advanced concepts—and lets investors decide which is more appropriate for them.

529 College Savings Center

The NASD College Savings Center, also accessible through www.nasd.com, includes information about 529 plans—both prepaid tuition and college savings plans—and other options, including savings bonds, Coverdell Education Savings Accounts and custodial accounts. 529 plans have generated a lot of interest—and for good reason. These are excellent vehicles for saving and investing for your children's or grandchildren's college

education. The prepaid version is a savings option that allows investors to lock in tuition prices, with lump-sum and installment payments based on the child's age and number of years of tuition being purchased. Besides being a type of forced savings, the prepaid plan can be a hedge against rising college costs, which in the past decade have outpaced inflation, in some years by a wide margin. 529 college savings plans do not lock in college costs, but earnings grow tax free and withdrawals are also tax-free when used for qualified education expenses, which include tuition, fees, books and supplies, and room and board. 529 college savings plans are offered by state governments and almost every state has one, but they're not all the same. For example, some states give tax deductions or credits to 529 plan investors, on top of tax-free earnings growth at the federal level, but others do not. In addition, the investment choices, fees and other features of 529 plans vary from state to state, so the NASD site can help investors choose carefully. Our College Savings Center offers tips for choosing from the various college savings options. Since 529 college savings plans carry fees and expenses—and because there are a lot of plans to choose from—the Center also includes a tool that compares and analyzes expenses associated with these plans.

Retirement Savings Initiatives

We are also focused on two areas of investment that affect every American—retirement savings and retirement spending. To help investors on the savings side, we have developed a 401(k) Learning Center that walks employees through everything from the enrollment process, to the role of risk and reward when making allocation decisions, to issues of portability and the risk to your retirement nest egg from cashing out of your plan before retirement.

We are teaming with AARP and the Retirement Security Project to try to increase participation rates among employees whose companies offer 401(k) plans. A recent issue brief by the Employee Benefit Research Institute (EBRI) notes that almost a third of recently hired employees who are eligible to participate in their company's defined contribution plan do not participate, and participation rates for employees earning less than \$20,000 a year is even lower. A number of academic studies have found that changing the default option to require workers to opt out of, instead of opt in to, participation in 401(k) plans raises participation rates to more than 90 percent. The goal of this collaboration is to encourage employers to adopt this and other so-called automatic 401(k) enrollment options, in whole or in part.

On the retirement spending side, we will be launching a Retirement Income Management Center later this year. It's important that retirees—who have spent the better part of their adult lives accumulating wealth—be given information and resources to help manage this income wisely. In particular, given the longer life expectancies of baby boom retirees, the Center will provide tools and information aimed at managing retirement savings so that, if at all possible, the savings are not depleted too soon.

Investor Alerts and Other Publications

NASD has issued a number of investor alerts that warn people about potentially problematic or confusing products or practices. These include alerts on equity-indexed annuities; variable annuities; "stretch" IRAs and other products. Most recently, NASD issued an investor alert on early retirement investment pitches.

NASD Investor Education Foundation

NASD established the NASD Investor Education Foundation in December 2003, inspired in part by survey data that showed mainstream investors had a troubling lack of knowledge and understanding of markets and investment products. Since then, we have contributed \$31 million to the NASD Foundation, all derived from disciplinary fines. The endowment received another \$33 million from a court-ordered settlement of the SEC's research analyst cases, and there is another \$22 million still to come from that case.

The NASD Foundation issues grants to universities and non-profits for research and programs that help mainstream investors understand the markets and the complexities of investing. The Foundation is particularly concerned with population segments that are underserved, such as minorities, members of the armed forces and senior citizens.

Senior Outreach

Our senior outreach is informed by a study that examined why some older investors are more susceptible to investment fraud than others. The study exposes the various persuasion tactics criminals use to exploit seniors and offers strategies to help them avoid becoming victims. The report was released in cooperation with WISE Senior Services and the AARP Foundation. It's called *Off the Hook Again: Understanding Why the Elderly Are Victimized by Economic Fraud Crimes*. The study was published in July and is available on the Foundation's Web site, www.nasdfoundation.org.

The report included some surprising conclusions. For example, financial fraud victims tend to be more optimistic, less likely to use financial professionals and more financially literate than non-victims. The researchers also found that most investment fraud goes unreported, in part because victims are embarrassed about having fallen prey to it. Research such as this informs our approach to educating seniors about how to protect themselves from fraud. The NASD Foundation has begun formulating a plan to fund further research and develop an investor protection program and public awareness campaign to help seniors spot and reject the social persuasion tactics that con artists use.

Leveraging Resources through Strategic Grants and Partnerships

Investor education in all its forms is a critical aspect of what we do and we're quite proud to be doing it. But at the same time, we know that our education programs reach only a small percentage of the population that could benefit from them. That is why it is

essential that we, and others in the investor education community, leverage resources to reach the broadest number of people and partner with others.

Through grant making, the NASD Foundation funds programs that provide information and resources to audiences typically underserved by financial education programs. More than \$4.8 million dollars has been awarded to organizations for educational programs and research projects that reach out to, among others, minorities, young investors, Native American communities and the elderly. Last year, we tripled our grant making over 2004 levels, and committed \$ 3.4 million to programs and partnerships that support our communities, our men and women on the frontlines and young people.

Foundation Research Grants

Research grants offer experts a chance to provide insight into how investors make decisions, what information they need to make better-informed decisions and how to create better learning environments. For example, the Ohio State University will examine racial and ethnic influences on investment behavior in order to develop guidelines for effective investor education programs for African-American and Hispanic populations. Princeton University is examining psychological biases that play a role in poor investment decisions and developing and testing a set of interventions to promote wise investing by mitigating those biases.

All Americans—regardless of their background or goals in life—deserve the opportunity to create a secure financial future for themselves and their loved ones. The NASD Foundation awarded grants to organizations that are helping more Americans take control of their financial decision-making. For example, Kidz Online, a nonprofit group in Los Angeles, is producing an interactive financial literacy Web show comprised of ten educational episodes geared towards high school students. The episodes will be broadcast in schools around the country. The Metro New York Better Business Bureau's Foundation created a national education project that provides simple tools, in English and Spanish, to guide financial decision making.

SaveAndInvest.org

Last year, as the result of a settlement with a broker-dealer that was targeting members of the armed forces with misleading sales pitches and improper sales tactics, approximately \$6.8 million was transferred to the NASD Investor Education Foundation for the development and deployment of comprehensive financial education programs for members of the armed services and their families.

Before developing this programming, NASD conducted a survey of the military population. Many servicemembers reported having difficulty covering expenses and saving for the future. Research conducted in June 2005 found that only 29 percent of military personnel who currently invest received a passing grade on a quiz about basic financial knowledge. However, 62 percent of survey respondents said that they planned to increase their investment levels in the next year.

Working closely with the Department of Defense, the NASD Foundation launched a multifaceted military financial education program early this year. This comprehensive campaign to help servicemembers and their families manage their money with confidence is being implemented on military installations worldwide. It encourages members of the armed forces to take control of their financial futures—by providing them and their spouses with financial information to help them make intelligent saving and investing decisions. As a result, servicemembers and their spouses now have access to financial tools and information 24 hours a day through a program created to meet the unique needs of the military community.

The program includes an online resource center, www.SaveAndInvest.org, that serves as a centralized source of unbiased information on saving and investing. We are also supporting the Defense Department's Personal Financial Management program by establishing a coordinated and uniform financial education program, including the training and continuous certification of personal financial counselors and other volunteers.

We have instituted a spousal fellowship program that will train a corps of military spouses to provide financial counseling and education within the military community. One of the publications we have developed with the National Military Family Association and the National Endowment for Financial Education is called Money and Mobility. It helps servicemembers and their families deal with the financial issues arising from deployment and duty-station changes. We have distributed over 270,000 copies of this publication to service members and their families.

Soon after launching SaveAndInvest.org in January 2006, an NASD Investor Education Foundation team traveled around the world to conduct a series of free financial education forums at bases and duty stations in the United States and far beyond our borders, including aboard the San Diego-based USS Ronald Reagan, an aircraft carrier then in the Persian Gulf.

This program is a broad collaborative effort. First and foremost, we are working closely with the Department of Defense, the United States Securities and Exchange Commission, the Federal Trade Commission and the Board of Governors of the Federal Reserve System. Our partners in this journey also include the National Military Family Association, the California Department of Corporations, the Association for Financial Counseling and Planning Education, the InCharge Education Foundation, the National Endowment for Financial Education, the American Savings Education Council, CincHouse.com and the Consumer Federation of America. By forming partnerships with groups such as these, which have experience in addressing military audiences, we complement the NASD Foundation's commitment to providing financial education information and resources to service members and their families.

NASD Regulatory Work to Protect Investors

NASD protects investors by adopting rules to govern the conduct of the securities industry; examining securities firms to determine whether they are complying with those rules, both on a periodic basis and in response to customer complaints and other red flags; and disciplining firms and brokers who fail to comply—imposing sanctions ranging from censures to fines, suspensions and expulsion from the industry. In our routine examinations of broker-dealer firms, NASD focuses on sales practice issues, including suitability, the requirement that a recommendation of a securities transaction be appropriate for the investor to whom it is made. Misconduct by firms is identified in several ways, including our sales practice reviews, customer grievance reviews, advertising/sales literature reviews and sweeps, which are series of targeted examinations involving particular products.

Investor Complaints and Dispute Resolution

NASD's goal is not only to be a source of critical information for individual investors so they can make better-informed decisions, but also to take direct action to protect them. Despite our best efforts to protect investors, however, problems do occur. What recourse do investors have if they feel that they've been treated unfairly or misled?

In addition to contacting the securities firm's compliance department to discuss a broker's unfair or improper conduct, an investor may lodge a complaint directly with NASD. Investigating complaints from investors is a significant function of NASD, and we look into all complaints that we receive. Alert investors have helped NASD successfully discipline many firms and brokers that have violated NASD rules or the federal securities laws. To report a problem, investors may submit complaints online via our Web site or send a letter to the NASD Complaint Center.

Although the vast majority of investors will never need to resolve an investment-related problem, all investors should know that NASD operates a dispute resolution forum, which handles more than 90 percent of securities arbitrations and mediations in the country. To get more information or the forms needed to begin such a process, investors may visit our Web site or contact one of the NASD Dispute Resolution offices. By clicking on the Arbitration and Mediation tab at the NASD Web site, investors can access a list of the Dispute Resolution regional offices and hearing sites.

Conclusion

Thank you for giving us the opportunity to testify on these important topics and for your important work on this issue.