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OFFICE OF THE SECURITIES COMMISSIONER

Mark Parkinson, Governor
Marc S. Wilson, Commissioner

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Testimony of Marc S. Wilson,
Securities Commissioner of the State of Kansas,

Before the Subcommittee on Oversight and Investigations,
Committee on Financial Services,
United States House of Representatives

Hearing on "Empowering Consumers: Can Financial Literacy Education Prevent Another Financial Crisis?"

August 24, 2010

Chairperson Moore, Congresswoman Jenkins and Members of the Committee,

As Kansas Securities Commissioner, I am responsible for protecting and informing Kansas investors, promoting integrity and full disclosure in the marketing of financial services and fostering capital formation. As you may well know, in 1911 Kansas became the first state to regulate securities, predating the federal securities acts by over twenty years and forming the basis for the system of registration and disclosure we have today. Like the Securities and Exchange Commission ("SEC"), the Office of the Kansas Securities Commissioner ("KSC") regularly examines both investment advisers ("IAs") and broker-dealers ("BDs") located in Kansas. Unlike the SEC, KSC also has trained and duly-sworn law enforcement officers who investigate allegations of illegal and unregistered activities. Additionally, in cooperation with district and county attorneys, KSC prosecutes its own cases; we are not reliant upon local, state or federal prosecutors to take and try cases. Consequently, securities fraud receives the specialized attention it deserves from law enforcement in Kansas.

Today I will focus on KSC's role as a financial services educator. Unfortunately, we see the consequences of financial illiteracy every day. As you might expect, the victims in our cases often lack basic understanding of many financial concepts, including portfolio risk and a basic knowledge of consumer financial products and how to obtain professional investment advice. All too often, consumers without this basic understanding are easily lured into fraudulent investment schemes with promises of high profits and little risk. Without an adequate foundation of financial skills, retail investors cannot ask meaningful questions and are left to take the word of people with a pecuniary interest in selling an investment.

We also find that the targets of our investigations lack basic financial literacy skills. In today's society, many entrepreneurs have grown accustomed to living in debt. If an entrepreneur also lacks budgeting skills, the debts can easily escalate until the entrepreneur becomes desperate to raise capital from any source, legal or not. Even entrepreneurs with the best intentions can end up taking the low road of making exaggerated claims about their business or minimizing its risks to investors.

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I am convinced not only that financial literacy education can be an effective tool to protect people from losing their life savings in investment scams, but that these skills must be taught to our young people as part of their school curriculum starting from a very young age. There will always be a need for outreach to populations particularly vulnerable to fraud like veterans and seniors, but integration of financial literacy into school curriculum from an early age would give consumers a foundation from which they can update their knowledge throughout their lifetime as their financial needs change.

Without answers to these basic questions -- What is a mortgage? How do checking and savings accounts work? How does the stock market work? What is a bond? How much risk is appropriate for me? How can I save for retirement without tax penalties? How much insurance do I need and of what type? -- consumers do not even know what questions they should be asking. If financial education merely results in consumers taking on less debt of the wrong type, this alone would play an important role in preventing another financial crisis.

Initiatives to Promote Financial Literacy Education

Kansans are fortunate that the Kansas Legislature created an investor education fund, administered by KSC, to finance investor education initiatives. Penalties assessed by KSC are deposited into a fund created for that specific purpose. *See* K.S.A. 17-12a601(d). KSC uses the investor education fund to make presentations to a wide variety of community organizations. KSC also provides grants to other organizations engaged in financial literacy training. For example, with an investor education fund grant, a Topeka non-profit organization, Housing & Credit Counseling, Inc. ("HCCI"), will next month be conducting a multi-week financial literacy training series called "Women & Money." Unfortunately, as a registered credit counselor, HCCI often reaches its target audience after they have encountered financial difficulties.

Though KSC will continue its support for HCCI and others, prevention is our primary focus. For many years, KSC has given $10,000 per year to the Kansas Council on Economic Education ("KCEE") to help promote "The Stock Market Game" in Kansas schools. The Stock Market Game was developed by the Securities Industry and Financial Markets Association ("SIFMA") and is designed to introduce students in grades 3-12 to the financial markets as they learn math, social studies, economics and language arts. In the game, teams of three to five students invest a hypothetical $100,000 into stocks, bonds and mutual funds with the goal of maximizing their long term gain. The students learn to cooperate and communicate in managing the portfolio. According to a study in August 2009 conducted by Learning Point Associates and funded by the Financial Industry Regulatory Authority ("Finra"), The Stock Market Game substantially improves student math scores on standardized tests and improves student investor knowledge. *See* Attachment A.

Because of encouraging results like these, last year KSC increased its investor education fund support for KCEE and The Stock Market Game to over $25,000, a level sufficient to permit every interested Kansas student to participate regardless of their ability to pay. The results were nothing short of amazing. Participation in Kansas went from 443 teams to 1304, including 701 teams coming from teachers new to the program. Obviously, given the benefit to Kansas students of participating in this type of applied mathematics, KSC intends to continue its efforts in this regard, especially in trying to reach teachers with the message that this free, off-the-shelf, ready-made curriculum dovetails with state mandates in both mathematics and financial education. The bottom line is that teachers need to know that financial education of this type fits squarely with improving student performance on mandated achievement tests.

There are, of course, other methods of investor education, some of which KSC tried. In 2006 and 2007, KSC employed a mass media approach, primarily on television, focusing on prevention of investment fraud. The campaign resulted in a short-term increase in constituent contacts with our agency, most of which were reports of fraud for which KSC does not have jurisdiction. While KSC's advertising was not specifically focused on financial literacy efforts, the paid advertising television medium is likely not as effective as focusing efforts on school-age children and the primary targets of investment scams, the elderly.

Major Barriers to Greater Financial Literacy

I believe that financial literacy education should be targeted at these two primary audiences. Scam artists typically target seniors because they often have significant retirement nest-eggs, so an effort must be made to equip seniors with the necessary skills to protect themselves. In addition, I believe a much greater effort should be made to teach students fundamental skills like budgeting, saving and investing. These skills will serve them when they decide how much debt to incur for higher education, as well as when they enter the workforce and decide on their appropriate amount of insurance coverage and how to maximize retirement savings or an employer's 401(k) match.

An obvious barrier to teaching financial literacy in schools is the fact that teachers are already expected to teach a full curriculum, and the renewed focus on the "3 R's" tends to crowd out everything else. However, as discussed above, there are many free resources that educators can use to introduce financial literacy skills within the context of the ordinary math or social studies curriculum. The real barrier, then, is the lack of familiarity amongst educators about these free resources and the ease with which they can be used.

Other Observations and Suggestions

The financial regulatory environment can sometimes contribute to the public's confusion about financial matters. For example, the average consumer should not be expected to understand that an investment adviser has a fiduciary standard in providing investment advice, while a stock broker is only required to sell "suitable" investments. *See* Attachment B.

As a securities regulator, I certainly understand the differences between BDs and IAs, and that the purpose of the BDs is to sell an offering to raise capital for its firm's clients. This is a critically important part of capitalism that cannot be replaced. However, what does not work is when retail investors are placed in investments that they never would have considered had they received the advice of a fiduciary. To the extent possible, Congress and regulators should work to adopt sensible, consistent regulations that are understandable to the general public for anyone -- BD or IA -- giving investment advice to retail investors. This would help to make financial literacy education seem less daunting and ensure that investors and those from whom they receive investment advice have the capacity for an informed discussion about the investor's needs before taking on portfolio risk. Further, just because Congress directed bank regulators to be more consumer-friendly does not mean that this should substitute for the sound, educated discretion of an informed consumer or investor.

Can Financial Literacy Education Prevent Another Financial Crisis?

Although I do not claim to be an expert on the root causes of the financial crisis, it appears to me that financial illiteracy contributed in a material way. Consumers who lacked basic budgeting skills were sold homes they could barely afford even under perfect circumstances. They failed to understand the risks of rising interest rates, falling property values, unemployment, unexpected medical emergencies or the myriad of other financial risks involved in taking on consumer debt. The effect on the housing market of securitized products with poorly underwritten mortgages as collateral, combined with a dramatic spike in energy costs, created a toxic mix for consumers who were living on the financial edge. The loss of a job or an illness was all it took to miss the next mortgage payment and fall permanently behind on one's financial obligations.

The American economy is driven by the consumer. If the consumer is taught to budget, save, and invest appropriately, the consumer will be able to weather economic storms more effectively, and the likelihood of a major shock to the economy is decreased. There is no guarantee that financial literacy, by itself, will prevent another financial crisis, but it would certainly make a crisis less likely.

Furthermore, financial literacy is the key to creating (or re-creating, as the case may be) an American economy that is not driven by consumption, but instead appropriately balances consumption with savings and investment. Were Americans as prodigious savers as they are consumers, then the U.S. would have an alternative path out of the recession, the same path that throughout its history the U.S. rode to greatness. That approach is to make capital available to the private sector not by purchasing unneeded or unnecessary goods (which are likely, in any case, made in China), but instead by placing excess cash into bank deposits, commodities, equities and government and corporate bonds, as did our forefathers. Transforming "consumers" into "investors" through financial literacy is a goal greater than preventing hardship or fraud, it is also the path toward turning our nation from the world's largest debtor into -- once again -- the world's largest creditor.

Thank you for the opportunity to share my opinions. I would be happy to answer any questions.

Respectfully submitted,

Marc S. Wilson

Marc S. Wilson
Kansas Securities Commissioner

Attachment A

[*See attached* Press Release, *Independent Study Finds Playing The Stock Market Game Yields Substantial Gains for Student Achievement in Mathematics and Financial Literacy*, Learning Point, Aug. 25, 2009.]

FOR IMMEDIATE RELEASE

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Independent Study Finds Playing The Stock Market Game™ Yields Substantial Gains for Student Achievement in Mathematics and Financial Literacy

Students who played The Stock Market Game simulation in schools scored higher in mathematics and showed greater investment knowledge

CHICAGO (August 25, 2009)—Learning Point Associates announced today that a rigorous randomized controlled trial of the Securities Industry and Financial Markets Association (SIFMA) Foundation's Stock Market Game found that students who played the game scored significantly higher on mathematics tests than their peers who did not play the game. Students playing The Stock Market Game, a financial literacy program taught in elementary, middle, and high schools, also scored significantly higher than their peers on tests measuring their financial literacy.

Learning Point's year-long study found that elementary school students in Grades 4–6 who played The Stock Market Game scored on average above the 55th percentile on the mathematics tests, while students who did not play the game scored on average above the 43rd percentile. Students in Grades 7–10 who played the game scored on average above the 54th percentile, while students who did not play the game scored on average above the 46th percentile.

Students who played The Stock Market Game also significantly outperformed their peers in their knowledge of financial concepts. In tests to measure investor knowledge, elementary school students who played the game scored on average above the 68th percentile, compared to an average score above the 42nd percentile for students who did not play the game. Students playing the game in both middle and high school scored on average above the 58th percentile, while their peers scored above the 42nd and 40th percentiles respectively.

Student achievement increased regardless of how teachers implemented The Stock Market Game. Analyses from the study revealed that most teachers used familiar, basic teaching practices when implementing The Stock Market Game, suggesting that the game is easy to implement using standard teaching approaches. Some teachers reported supplementing basic practices with activities that required additional time and expertise, such as projects and field trips. Students of these teachers reported especially high levels of engagement and interest in the game. In some cases, advanced teaching practices led to even greater student benefits. The study found that the more advanced teaching practices that teachers engaged in, such as playing the game along with students, the better students in the upper grades performed on the mathematics test.

Regardless of the classroom techniques—basic or more advanced—an analysis of students' test results found that students playing The Stock Market Game showed better performance on the mathematics and financial literacy tests than their nonplaying peers.

Students are not the only ones to benefit from exposure to The Stock Market Game. Teachers of The Stock Market Game reported that the program influenced their financial practices. In a nationwide survey conducted as part of the study, many teachers reported that they were influenced to set financial goals, analyze their risk tolerance, read the business section of the newspaper, and watch financial programs as a result of teaching the game.

The study was funded by a grant from the Financial Industry Regulatory Authority (FINRA) Investor Education Foundation. The FINRA Foundation wanted to provide reliable information to teachers, parents, and students on the effectiveness of widely used financial literacy programs.

"The results showing significant gains in mathematics achievement and investing knowledge are very encouraging," said FINRA Foundation President John M. Gannon. "This was a study of uncommon rigor, and we are hopeful that independent evaluation analysis of this type will lead to a better understanding of the effectiveness of financial education."

About the Study

Learning Point Associates conducted a randomized controlled trial with nearly 600 classrooms nationwide. Approximately half of those classrooms played The Stock Market Game and half did not. Learning Point Associates surveyed students who participated in the study to measure their engagement with the game, their development of financial literacy skills, and their application outside of the classroom of the skills taught in the game. More than 2,700 students were surveyed. Learning Point also conducted a nationwide survey of teachers of The Stock Market Game. More than 4,800 teachers who had taught the game within the previous year, including those participating in the study, completed the survey.

The Stock Market Game is an educational program of the SIFMA Foundation. Since 1977, nearly 12 million students have participated in The Stock Market Game.

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<u>Attachment B</u>

[*See attached* Pamela Yip, *Know What Roles Stockbroker, Investment Adviser Play in Handling Your Money*, Dallas Morning News, Aug. 21, 2010.]

dallasnews.com
The Dallas Morning News

Know what roles stockbroker, investment adviser play in handling your money

03:47 PM CDT on Saturday, August 21, 2010

By PAMELA YIP / The Dallas Morning News
pyip@dallasnews.com

When you hire a professional to advise you on your finances, you want to be confident that that person has your best interest in mind.

Most financial professionals operate in that manner, but you need to be careful and make sure you're hiring the right individual to meet your needs.

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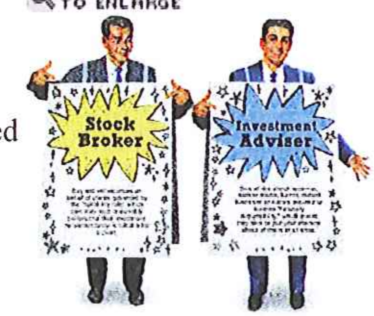

MICHAEL HOGUE/Staff Artist

The critical question to answer: Do you need a stockbroker or do you need an investment adviser?

Because the average investor doesn't know the difference, he or she may enter into a business relationship with the wrong assumptions, said Richard Lewins, a former stockbroker and now a Dallas lawyer who represents investors.

"Most people do not know there are different duties/responsibilities between registered investment advisers and brokers," he said. "They lump all investment professionals into one fungible group, unless they specifically are told the difference."

The term "investment adviser" describes a broad range of people who give advice about securities, such as stocks, bonds, mutual funds and annuities. Investment advisers also may go by the titles of investment manager, investment counsel, asset manager, wealth manager or portfolio manager.

Stockbrokers are financial professionals who buy and sell securities on behalf of clients. They're also known as financial consultants, financial advisers and investment consultants.

While the two are similar, there is a subtle, yet crucial, difference:

•Stockbrokers are governed by the "suitability rule," which means they're required to recommend investments that are suitable for you based on their knowledge of your financial situation and needs.

•Investment advisers, on the other hand, are required to exercise "fiduciary responsibility," which means they have to put your interests ahead of theirs at all times when providing advice and recommendations.

Most investment advisers charge a fee based on a percentage of the assets in your account. Typically the larger your account, the lower the percentage.

Stockbrokers are typically paid through commissions paid each time the broker buys or sells a security for a client.

They also may be compensated through fees for investments and services.

Lewins said that since many investors don't know the difference between investment advisers and brokers, "their assumption is that all financial advisers have the same duty, i.e., to always have the client's best interest first."

Most brokers do have their client's best interest at heart when making investment recommendations, but they're not required to meet this standard.

So an investment "could be suitable for 90 percent of the population and still not be suitable for you," said Gary Morris, a registered investment adviser and certified financial planner in Dallas.

Study ordered

In the financial-regulatory law passed this summer, Congress directed the Securities and Exchange Commission to conduct a six-month study of the effectiveness of existing standards for brokers and investment advisers, and whether there are gaps, shortcomings or overlaps in the current regulations.

Aug. 30 is the deadline for submitting public comments to the SEC.

I encourage you to speak your mind because the regulators need to hear from average Americans.

After the study, the SEC is authorized to issue rules regarding the standard of care for professionals who are providing investment advice.

Consumer advocates, financial planners and brokerage industry representatives have said the fiduciary standard should apply to both investment advisers and brokers.

"When broker-dealers and investment advisers engage in the identical service of providing personalized investment advice about securities to individual investors, they should be held to a uniform, federal fiduciary standard of care," John Taft of the Securities Industry and Financial Markets Association said in congressional testimony. The group is the trade association for the brokerage industry.

Opponents of the fiduciary standard say the additional risk of lawsuits involving brokers would increase costs to consumers. They also argue that suitability standards are already stringent and heavily enforced.

"Compliance cost both in terms of finances and time are high, and those costs are eventually felt by clients," Charles R. Green, a Hurst broker, wrote in comments to the SEC.

"Thus adding another layer of regulation means another layer of compliance, and even more cost to clients."

One regulator expressed concern that the SEC might embrace a weaker standard than currently exists.

"The SEC is highly likely to adopt some standard that they're going to label 'fiduciary standard,' but I am not sure – and I'm very concerned – that it won't be the fiduciary standard that exists under the 1940 act that we have had for investment advisers forever," said Denise Voigt Crawford, Texas securities commissioner.

Questions to pose

However the SEC decides to resolve the issue, it's important that you ask key questions before you pick an investment services provider.

Here are some good ones from the Coalition for Investor Education, which consists of state securities regulators, consumer advocates and representatives of the investment adviser and financial planning industries:

•What services do you offer?

•What qualifications do you have?

•How do you charge for those services? Do you receive compensation from other sources if you recommend that I buy a particular stock, mutual fund or bond?

•Are you required by law to always act in my best interests? Will you put that commitment in writing?

•What potential conflicts of interest do you have when recommending investment products to me, and will you disclose those conflicts?

•Will you provide me with a written record of any disciplinary history for you and your firm?

Any reputable provider should be happy to discuss these issues with you and answer any other questions you may have.

But regardless of whether you hire an investment adviser or a stockbroker, remember that it's your money on the line, and no one will care about it as much as you.

WHAT'S THE DIFFERENCE?

Stockbrokers: Buy and sell securities on behalf of clients; governed by the "suitability rule," which says they must reasonably believe that their investment recommendation is suitable for a client.

Investment advisers: Give advice about securities, such as stocks, bonds, mutual funds and annuities; required to exercise "fiduciary responsibility," which means they have to put your interests ahead of theirs at all times.