

**TESTIMONY OF
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U.S. SECURITIES AND EXCHANGE COMMISSION**

CONCERNING FINANCIAL LITERACY

BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

February 5, 2002

Chairman Sarbanes, Senator Gramm, and Members of the Committee:

I am pleased to be here this morning to offer the Securities and Exchange Commission's perspective on financial literacy and education in today's securities markets. I am especially gratified, Chairman Sarbanes, that you and the Committee have taken the initiative to raise the visibility of this important issue that has only become more significant in light of recent events.

Achieving financial literacy for all Americans has always been an important goal. With so many individuals and employees invested in our securities markets today, financial literacy is now not only important but an essential goal. In my testimony today, I would like to offer some observations on the landscape of financial literacy and education from the SEC's perspective.

As the events of last September demonstrated, our capital markets are the world's strongest and most resilient. Our markets are not located in any one building or city or place. Rather, they are networks of people and ideas and freedom. Thus, they are emblematic of our great Nation. Precisely for these reasons, all Americans should have the opportunity to participate in our markets. Financial literacy is a crucial foundation for participation. People need to be able to "read, write and speak" basic financial concepts in order to make informed investment decisions.

Beyond basic fairness issues, there are significant economic and social benefits of financial education. People of even modest means can realize financial security and all that it promises - such as buying a home and pursuing educational opportunities. As a society, we should want all Americans to have the opportunity and the ability to invest in our markets. Historically, investing in the market has resulted in returns superior to other savings strategies. Investment dollars help our Nation's businesses and economy grow stronger, and ensure that new and creative technologies have a chance to develop and flourish. Saving and investing enrich and bring stability to individuals and families. With the decline in defined benefit retirement plans and the concurrent rise in defined contribution plans, workers increasingly need to be able to evaluate investment options thoughtfully, in order to provide for their retirement security.

We learned, in the wake of the Great Depression, when world economic forces caused precipitous and calamitous declines in equity market values, that investors are willing to commit their capital to our markets only if they have confidence that those markets are fairly and honestly run, are fully transparent, and affirmatively minimize the risk of loss from selective disclosure, fraud and manipulation. The trust and faith investors place in our capital markets have fueled incredible economic growth, improved our collective standard of living, and made it possible for innovators to see their ideas come to fruition. The success of our markets has been due not just to their depth and breadth, but also to their quality and integrity.

Our markets must be transparent and hospitable to all investors. Ours is a disclosure-based system. And it is our job to promote clear, accurate and timely disclosures – proactively. Once investors are fully informed, we leave it to them to evaluate the merits of an investment. Of course, when investors are not fully informed – when they are misled – it is our job to prosecute the wrongdoers. The federal securities laws police fraudulent, deceptive and manipulative conduct. Vigorous and timely enforcement of these provisions plays a critical role in ensuring market transparency. Where investor interests are being disserved or abused, we seek to take immediate action to halt violative conduct and then undo its effects. Aggressive enforcement helps prevent continued fleecing of the investing public. It publicly identifies wrongdoing, which helps educate investors about that particular fraud as well as raise public awareness of the kinds of schemes and pitfalls out there. Vigorous enforcement punishes wrongdoers, stamps out recidivism, and deters future misconduct. It also prevents the dissipation of investor assets. Our goal is to protect investors and we will pursue securities law violations and financial fraud aggressively. But an educated investor is the first defense against fraud.

Educating people about how to manage their money effectively and achieve retirement security demands participation on all levels: local, state and national. Public-private partnership is essential. This is the same approach that our Country has taken to promote literacy, itself the first step toward achieving financial literacy. The federal government can play an important role in achieving financial literacy. First, it can stimulate localities and the private sector to initiate financial education. People learn locally - through schools, workplaces, newspapers and other media, and religious organizations.

The Commission works with numerous public and private organizations to foster educational programs. For example, we have provided curriculum material for the Department of Agriculture's Cooperative Extensive Service to include in their financial education course - which is widely distributed. We are an active member of the "Jumpstart Coalition," a public-private partnership that seeks to foster youth financial literacy education. We also partner with the American Savings Education Council (ASEC), a public-private partnership devoted to increasing investor education. Our staff has given presentations to countless schools, religious organizations and investor clubs, explaining basic investing concepts and answering questions. Our staff also hosts

“Investor Town Meetings” across the United States, bringing together industry, federal and local government officials to educate investors on basic financial concepts.

Government can play a second critical role in the national initiative of financial literacy by providing investors and potential investors with neutral, unbiased information on saving and investing. We have worked with industry trade groups and other federal and state regulators to produce an extensive array of educational material directed at helping people make wise investment choices and avoid fraud. We hand out and mail brochures on how to interact with financial professionals, on Internet investing, and many other topics. We do not copyright our materials. In fact, we encourage the private sector and other federal and state regulators to copy and use them. Private entities frequently ask us for bulk shipments to hand out to customers. Many foreign regulators have, with our active encouragement, taken our material and adapted it for their investing audiences.

One example of the many informational brochures we compile to educate investors is called “Analyzing Analyst Recommendations.” Our alert discusses the potential conflicts of interest analysts face and provides tips for researching investments. Analysts often use a variety of terms — buy, strong buy, near-term or long-term accumulate, near-term or long-term over-perform or under-perform, neutral, hold — to describe their recommendations. But they rarely urge investors directly to sell the stocks they cover. Working with the Congress and the securities industry, we are on the threshold of new rules that will create more transparency for analyst recommendations. As a general matter, investors should not rely solely on an analyst’s recommendation when deciding whether to buy, hold, or sell a stock. Instead, they should also do their own research — such as reading the prospectus for new companies or for public companies, the quarterly and annual reports filed with the SEC — to confirm whether a particular investment is appropriate for them in light of their individual financial circumstances.

We post all of our educational material on our website, and we have taken advantage of the Internet to create interactive tools to help inform people’s investment decisions. For example, we created a mutual fund cost calculator, which allows investors to compare the costs of holding different mutual funds over a period of time that they specify. We also have an extensive tutorial on the use of margin, which includes a calculator for assessing the true costs associated with a margin account. We have an interactive quiz to “test your money smarts,” and an interactive question-and-answer database, through which investors e-mail us questions. We generally reply to these e-mails within two business days.

The Internet has emerged as a major source of investment leads for many Americans, rivaling the old “water cooler” chats of a different era. We have all witnessed the willingness of otherwise thoughtful people to believe what they read on unverified websites, in unregulated chat rooms, and through claims of sure things by individuals who probably were (or could have been) snake oil salesmen in prior lives. Investors become easy prey for cyberspace sharpshooters who spread disinformation, or use their virtual pulpits to promote their ability to sell their own holdings at a profit.

Unfortunately, there always will be people who allow dreams of untold wealth to distort their better judgment. So we have redoubled our efforts to arm investors with the information they need to invest wisely.

Recently we began a major new initiative to post fake scams on the Internet similar to those that fraudsters successfully use to separate investors from their hard-earned money. We took this step in order to bring our educational information to the screens of Internet users who have not tapped the wealth of educational material located on our website. The fake scams are all modeled on “real” scams from cases we have brought. In this initiative we are working with state securities regulators, foreign regulators, other U.S. government agencies such as the Treasury and the Federal Trade Commission, the National Association of Securities Dealers and trade associations to bring educational messages to those investors who click on our sites in search of unrealistically high returns.

Last week we announced that we had created the fake scam site, www.mcwhortle.com. The McWhortle site graphically illustrates what we’ve been telling investors for years:

- *If it sounds too good to be true, it is.*
- *“Guaranteed returns” aren’t.* Most fraudsters spend a lot of time trying to convince investors that extremely high returns are “guaranteed” or “can’t miss.”
- *Check out the company before you invest.* Look at financial statements. Find out if the company has ever made any money. And by the way - if a supposedly upright firm only lists a P.O. box, as McWhortle did, you’ll want to do a lot of work before sending your money!
- *If it is that good, it will wait.* Scam artists usually try to create a sense of urgency - implying that if you don’t act now, you’ll miss out on a fabulous opportunity. But if you’re being pressured to invest, especially if it is a once-in-a-lifetime, too-good-to-be-true opportunity that “just can’t miss,” just say “no.”
- *Understand your investments.* Fraudsters frequently use a lot of big words and technical-sounding phrases to impress you. But have faith in yourself! If you don’t understand an investment, don’t buy it; and
- *Beauty isn’t everything.* Don’t be fooled by a pretty website - they are remarkably easy to create.

The sole out-of-pocket cost of this educational project was \$50 to register the McWhortle domain name. We’ve had more than a million hits on the site thus far. We think this is a low-cost, high impact way to reach potential investors. Crooks figured out a long time ago how to best separate people from their money. Our website graphically illustrates fraud to investors, so that the next time they encounter a “real” scam, they’ll

know what it is they are dealing with. We've always thought that an educated investor is our best defense against fraud. This initiative is helping educate investors.

The response from the public has been overwhelming. These are representative responses that we've received about the site:

Fantastic!!! This is an excellent idea for reaching exactly the audience that needs this warning. Congratulations are in order for the individuals responsible for this imaginative communications concept.

WELL DONE!
VERY NECESSARY AND VERY WELL DONE!
Thank you for your efforts, I have forwarded the initial link to all of my e-mail friends.
NICE TO SEE TAX DOLLARS WELL SPENT!!!
YOU SHOULD CONTINUE WITH OTHER TYPES/VERSIONS OF THE SAME UNTIL YOUR MESSAGE IS RECEIVED BY ALL

This is an excellent idea. Kudos for creative thinking.

Dear SEC,

Thank you for this clever exercise in public education. I was alerted to your site from an author on Realmoney.com...just wanted to see how effective it might be in attracting gullible investors.

Good luck with all that confronts you; I appreciate your efforts in attempting to protect the public from unscrupulous scoundrels.

very clever and helpful -- I know there are a ton of people whose eyes will be opened by this

great site, great lesson -- I saw the story on Reuters about how the site was created to educate investors. I hope you keep the site up as I would like to point to it in a business class I talk at each quarter.

The McWhortle site was launched with the assistance and support of the Federal Trade Commission, the National Association of Securities Dealers, and the North American Securities Administrators Association. We have other fake scams out there as well. The Treasury Department has partnered with us on one of them, a "Prime Bank" fraud. Scotland Yard has also joined forces with us.

Beyond educating investors, we are also looking to improve the quality of information they receive. Confidence in our markets begins with the quality of the financial information investors use to decide where to invest their hard-earned dollars. Comprehensible information is the lifeblood of strong, vibrant markets. Our current disclosure system is the best in the world. However, as more and more Americans are entering our markets and making increasingly difficult investment decisions that affect their lives, savings goals and retirement security, we need to ask whether we have done the best job possible in making financial statement and other disclosures timely and understandable to all investors. Are we meeting investors' needs?

In his State of the Union Address, the President appropriately demanded "stricter accounting standards and tougher disclosure requirements." He wants corporate America to "be made more accountable to employees and shareholders and held to the highest standard of conduct." The SEC shares and embraces these principles, and we are firmly committed to making them a reality. As part of the President's Working Group on Financial Markets, we are working with Secretary O'Neill and Chairman Greenspan, as well as Chairman Newsome of the Commodity Futures Trading Commission, to conduct a full review of corporate disclosure rules. The SEC is ready to develop and implement reforms. We are firmly committed to improving corporate disclosure and assuring that the accounting profession functions properly, fairly and in the public interest.

In all of our investor education materials, we advise people to "do their homework," by which we mean primarily looking at the SEC filings of a company in order to evaluate whether it is a good investment. It is tremendously important for investors to be able to understand and evaluate the information that the SEC requires issuers to make available. A critical step towards enhancing national financial literacy is to make more intelligible and more timely the financial data we require issuers to file. We need to rethink our financial disclosure model, with an eye toward simplifying it so that everyone can understand the fundamentals of every company and find absolute comparability from firm to firm. This task has become increasingly critical as more and more individuals become direct participants in our markets and face increasingly difficult investment decisions that affect their lives, savings goals and retirement security.

Our existing disclosure system must be strengthened, and supplemented, in order to put information into investors' hands more promptly, and help investors. Several attributes are clearly required if we are to enable all of our citizens to identify the opportunities that abound in our marketplace, and to avoid the pitfalls that lurk behind every opportunity.

- Supplementing periodic disclosure with "current disclosure." In the system we envision, public companies will be required affirmatively to disclose unquestionably significant information when it arises and becomes available, even if the information is learned between scheduled periodic reports.

- Making use of technology to simplify disclosure documents without sacrificing the wealth of information companies are accustomed to supplying, and without unduly disadvantaging those investors who lack Internet access.
- Encouraging the use of so-called “trend” information, to give investors the same kind of view of the companies in which they invest as is available to the managers of those companies.
- Making financial information comprehensible to the average investor.

We are committed to making disclosures more meaningful, and intelligible, to average investors. We are soliciting broad input. This May, the Commission will hold its first ever “Investor Summit” to solicit investor input on the policy issues that confront us as we begin reforming our disclosure and financial reporting process.

The SEC in essence has a two-fold task ahead of us: first, improving corporate disclosure and strengthening financial accounting and reporting standards, and, second, raising our national consciousness so that investors fully understand the importance of researching investments before buying. Firefighters drill into school children the mantra of “stop, drop and roll.” We need to convince people to “stop, read and think.” To the extent that we can improve the clarity of what investors read, we will succeed in improving financial literacy in America.

There is no magic “bullet” that will accomplish our financial literacy goals. No one program will reach all groups. No one organization can do it all. Financial literacy for all can be accomplished only with enthusiastic cooperation by all. We look forward to continuing to work closely with this Committee and others to advance financial literacy in America.

I am happy to try to respond to any questions the Committee may have.