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The Contribution of the Fund Profile to Investor Education

James A. Fanto*

I. INTRODUCTION

More so than at any time in this nation's past, ordinary people are investing, directly or indirectly, in the capital markets.¹ Saving and investing are now important, everyday tasks for which they are responsible, but for which they may not be adequately educated. Therefore, the educational implications of any securities regulation affecting the ordinary investor must be carefully considered.

If investor education becomes an important area for securities regulators generally, it must naturally receive even more attention from mutual fund² regulators. In the recent past, investments by Americans in mutual funds have grown exponentially as mutual funds have become the investment of choice both in retirement and non-

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¹ See NEW YORK STOCK EXCHANGE, FACT BOOK FOR THE YEAR 1997 57 (1998) (discussing growth of individual stock ownership in America and noting that "one adult in every three owns corporate stock directly, indirectly through a stock mutual fund, or through shares that are held in a corporate thrift plan or defined contribution pension plan"); Edward Wyatt, *Share of Wealth in Stock Holdings Hits 50-Year High*, N.Y. TIMES, Feb. 11, 1998, at A1 (citing data of Federal Reserve indicating that Americans have more assets invested in stock market, as compared to other assets considered part of household wealth, than at any time in last 50 years).

² For simplicity's sake, my reference to mutual funds in this Article is to what are termed "open-end" management companies that sell redeemable fund shares. See 15 U.S.C. § 80a-5(a)(1) (1996). As a result of the Securities and Exchange Commission (SEC or the "Commission") regulatory initiative discussed below, mutual fund shares may now be offered in a new document.

retirement accounts (employer-sponsored or IRAs).³ This growth is not surprising, because mutual funds provide consumers with investment options and access to professional money managers that would otherwise be available only to the wealthy. Astute mutual fund investing can enable an ordinary investor to build the kind of optimal portfolio that basic finance suggests is critical to wealth enhancement (that is, a diversified portfolio with an asset allocation among investments with different risks that changes over the life cycle).⁴ Because of the popularity of mutual funds for consumer investing, securities regulators need to consider how mutual fund companies should educate investors to understand the advantages of mutual fund investing and the benefits of particular kinds of funds and fund investment strategies, and to comprehend fund disclosure.⁵

³ See INVESTMENT COMPANY INSTITUTE, 1998 MUTUAL FUND FACT BOOK 1 (1998) (describing growth in total assets in mutual funds from \$1.07 trillion in 1990 to \$4.5 trillion in 1997). Moreover, the number of mutual funds has more than doubled since 1990, see *id.* at 16, and approximately 16% of the \$6.6 trillion of total retirement assets at year-end 1996 was invested in mutual funds. *Id.* at 44.

⁴ See BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET 400-21 (6th ed. 1996) (providing basic explanation of life-cycle investing with differing asset allocations depending upon life stage).

⁵ This emphasis on investor education should be no surprise to the mutual fund industry and its regulators. Designed to serve the small investor who may invest on his or her own, the industry has always realized that investors need understandable descriptions of funds and the benefits of fund investing in order to encourage them to invest initially in mutual funds and to remain invested in them. Fund companies have thus experimented with ways of communicating to investors about issues that could be characterized as educational, such as the basics of saving and investing. See *infra* note 25. Similarly, because its regulated industry markets a product to ordinary investors, the Division of Investment Management of the SEC has likely been more sensitive than other divisions to issues of effective communication to investors and their ability to understand securities disclosure.

The SEC has standardized and simplified mutual fund disclosure because it recognized that fund investments were mainly designed for ordinary investors. See, e.g., Registration Form Used by Open-End Management Investment Companies; Guidelines, Investment Company Act Release No. 13,436, 48 Fed. Reg. 37,928 (1983) (adopting two-tier disclosure format for mutual fund registration with prospectus and Statement of Additional Information); Consolidated Disclosure of Mutual Fund Expenses, Investment Company Act Release No. 16,244,

This Article examines the educational implications of a new mutual fund disclosure format recently approved by the SEC⁶ that allows fund companies to market their funds by a summary document known as a "profile."⁷ Both the profile and significantly revised prospectus disclosure were part of a larger SEC project to improve overall fund disclosure and promote "effective communication" to fund

53 Fed. Reg. 3,192 (1988) (adopting uniform fee table in funds); Advertising by Investment Companies, Investment Company Act Release No. 16,245, 53 Fed. Reg. 3,868 (1988) (adopting uniform formula for calculating fund performance); Disclosure of Mutual Fund Performance and Portfolio Managers, Investment Company Act Release No. 19,382, 58 Fed. Reg. 19,050 (1993) (adopting uniform presentation of management's discussion of fund performance); Money Market Fund Prospectuses, Investment Company Act Release No. 21,216, 60 Fed. Reg. 38,454 (proposed July 26, 1995) (proposing amendments to simplify money market fund disclosure).

⁶ The following discussion admittedly highlights only one aspect of the educational issue regarding securities regulation, and only this regulation's effect on education regarding mutual funds, because it concentrates on education that mutual fund companies provide directly to investors. Yet many ordinary investors, including investors in mutual funds, invest through or with the guidance of brokers and/or financial planners. There may well be a need to place educational responsibilities on such professionals to reach those investors who have no direct contact with the fund companies. See, e.g., SECURITIES INDUSTRY ASSOCIATION, INVESTOR EDUCATION HANDBOOK 6 (Nov. 1996) (encouraging financial firms to have their employees conduct more education of investors to respond to such investors' need and desire for education). Moreover, a more troubling issue is the adequacy (or even accuracy) of education conducted by "interested" parties, whether fund companies or brokers, and the possible need for "neutral" (or at least non-financial industry) education providers. See generally James A. Fanto, *We're All Capitalists Now: The Importance, Nature, Provision and Regulation of Investor Education*, 49 CASE WES. RES. L. REV. (forthcoming 1999) (discussing how competition in education services, both by for-profit and nonprofit firms, has produced a standardized educational product and how financial market regulators generally provide some basic investor education and oversee market efforts).

⁷ See New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7,513, 63 Fed. Reg. 13,968 (1998) [hereinafter, Final Profile Release] (authorizing fund profile that presents summary of key information about fund); Proposed New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7,399, 62 Fed. Reg. 10,943 (proposed Mar. 10, 1997) [hereinafter, Profile Proposal] (proposing fund profile).

investors.⁸ The Article argues that the profile initiative, as part of the larger regulatory undertaking, is educational in nature primarily because, by focusing investors' attention on certain basic fund features and their comparability with those of other funds,⁹ the new format in effect invites them to think about the kind of issues that investor education identifies as central to optimal investing. That is, requiring fund companies to put information into a format to which investors can easily apply saving and investing education encourages investors to recognize their need for this education.

This Article initially summarizes briefly the reasons for the importance of investor education in the United States and the need for U.S. securities regulators to examine their consumer-oriented regulations, particularly affecting mutual funds, from an educational perspective. In this connection, it refers to the large number of investor educational products and services developed and provided by fund companies, nonprofit organizations and even government regulators. It next identifies the educational importance of the profile within the overall educational orientation of the revised fund disclosure initiative. Finally, it argues that the SEC should now take a further regulatory step to make explicit the educational

⁸In effect, the revisions went to the entire fund registration statement, the Form N-1A, although key amendments altered the prospectus part of this statement. See Registration Form Used by Open-End Management Investment Companies, Securities Act Release No. 7,512, 63 Fed. Reg. 13,916 (1998) [hereinafter, Final Registration Release] (stating that amendments are intended to improve fund prospectus disclosure); Registration Form Used by Open-End Management Investment Companies, Securities Act Release No. 7,398, 62 Fed. Reg. 10,898 (proposed Mar. 10, 1997) [hereinafter, Registration Proposal] (same). This disclosure initiative also included a proposal regulating investment company names. See Investment Company Names, Investment Company Release No. 22,530, 62 Fed. Reg. 10,955 (proposed Mar. 10, 1997) [hereinafter, Names Proposal]. The SEC has not yet taken final action on this proposal.

⁹See Final Registration Release, *supra* note 8, at 13,917 (observing that the two major disclosure initiatives are "intended to: improve fund disclosure by requiring prospectuses to focus on information central to investment decisions; provide new disclosure options for investors; and enhance the comparability of information about funds").

implications of the profile by allowing, even requiring, fund companies explicitly to link the profile to their's and others' educational materials—thus alerting ordinary investors to the existence and importance of these materials.

II. THE NEED FOR INVESTOR EDUCATION

The importance of and need for investor education basically arises because saving and investing have increasingly become ordinary activities in the United States (and much of the developed world)¹⁰ that are as essential for survival in society as finding lodging and a job. This situation has emerged in the last two decades and owes much to the increased use by employers of defined contribution plans¹¹ that place upon the individual

¹⁰In another paper, I examine how investor education is becoming important in other countries for reasons similar to those explaining its growing significance in the United States, as outlined below. See James A. Fanto, *Comparative Investor Education*, BROOK. L. REV. (forthcoming 1999). See also GROUP OF TEN, THE MACROECONOMIC AND FINANCIAL IMPLICATIONS OF AGEING POPULATIONS (Apr. 1998) (discussing effects of increased longevity and declining fertility on pension systems in developed countries and possible need for funded, including individually funded, pensions). One example of the international significance of this subject is a recent SEC investor education campaign coordinated with countries in the Western Hemisphere. See *Overview: Get the facts. It's your money. It's your future.*, (visited Oct. 6, 1998) <<http://www.sec.gov/consumer/cosra/about/facts.htm>> (describing campaign and participation by securities regulators in twenty-one countries in Western Hemisphere).

¹¹See U.S. GENERAL ACCOUNTING OFFICE, PRIVATE PENSIONS: MOST EMPLOYERS THAT OFFER PENSIONS USE DEFINED CONTRIBUTION PLANS 4-9 (GAO/GGD-97-1, Oct. 3, 1996) (presenting growth statistics for defined contribution plans); Olivia S. Mitchell, et al., *Introduction: Assessing the Challenges to the Pension System*, in POSITIONING PENSIONS FOR THE TWENTY-FIRST CENTURY 1, 2-6 (Michael S. Gordon, et al., eds., 1997) (explaining shift to defined contribution plans). In the defined contribution plan, an individual sets aside a portion of his or her earnings in an account and may receive an additional contribution to it from the employer, and he or she must decide how to invest the funds within a limited number of options provided by the plan. See EMPLOYEE BENEFIT RESEARCH INSTITUTE, FUNDAMENTALS OF EMPLOYEE BENEFIT PROGRAMS 57-59, 70-72 (5th ed. 1997) (describing different types of defined contribution plans, including savings or thrift plans, profit-sharing plans, money purchase pension plans, employee stock

employee most of the responsibility for saving and investing for his or her retirement, at the expense of the defined benefit retirement programs¹² where an employer basically assumes this responsibility. Different explanations, ranging from the cost of defined benefit programs to the compatibility of defined contribution plans with the needs of an increasingly transient workforce, account for this shift.¹³ Whatever one's view of

ownership plans and 401(k) arrangements); *see also* U.S. GENERAL ACCOUNTING OFFICE, PRIVATE PENSIONS: PLAN FEATURES PROVIDED BY EMPLOYERS THAT SPONSOR ONLY DEFINED CONTRIBUTION PLANS 11-18 (GAO/GCD-98-23, Dec. 1, 1997) (describing contribution features of subset of defined contribution plans). In one well-known type of defined contribution plan pursuant to Section 401(k) of the Internal Revenue Code, an employee can defer, on a pre-tax basis, a portion of his or her compensation as a contribution to an individual retirement account and receive a matching contribution from an employer (generally, a percentage of an employee's earnings), at the employer's option. For an employer to receive certain benefits of such plans (chiefly, a limitation on its fiduciary liability with respect to the plan), applicable regulations stipulate that it must offer plan participants at least three investment alternatives that are each diversified and with different risk/return features. *See generally* Gordon P. Goodfellow & Sylvester J. Schieber, *Investment of Assets in Self-Directed Retirement Plans*, in POSITIONING PENSIONS FOR THE TWENTY-FIRST CENTURY 67, 70-71 (Michael S. Gordon, et al., eds., 1997).

¹² *See generally* EMPLOYEE BENEFIT RESEARCH INSTITUTE, *supra* note 11, at 69-70 (explaining that in "defined benefit" plans, employer provides employee with pension calculated in accordance with set formula, usually based upon years of service and percentage of pay). Defined benefit plans use different formulae: some pay a flat-dollar amount for each eligible year of service; others use a percentage of pay for each eligible year or a percentage of career-average pay; still others calculate benefits as a percentage of average pay in the final employment years. *See* JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 44 (2d ed. 1995). They are all designed to ensure that an employee works a set number of years before becoming eligible for (or "vesting" in) the plan. Although complicated, the vesting rules generally require a plan to vest an employee fully after either five or seven years of employment. *See* EMPLOYEE BENEFIT RESEARCH INSTITUTE, *supra* note 11, at 42-43 (noting that once vested, employee's rights generally cannot be revoked).

¹³ *See* Kelly Olsen & Jack VanDerhei, *Defined Contribution Plan Dominance Grows Across Sectors and Employer Sizes, While Mega Defined Benefit Plans Remain Strong: Where We Are and Where We Are Going*, EMPLOYEE BENEFIT RESEARCH INSTITUTE SPECIAL REPORT SR-33/ISSUE BRIEF NO. 190, Oct. 1997, at 13-14 (discussing costs of defined benefit plans, which include not only the actuarial help to

this transformation, it has clearly begun to focus the attention of ordinary individuals on saving and investing (particularly capital market investing) because individual investors are beginning to realize that their well-being in retirement will depend upon how much they save *now* and how well they invest their retirement funds.

Several other factors make individual saving and investing an urgent matter. First, for many people retirement may no longer be a brief period at the end of a working life, but a time that can extend for years because of decreases in mortality and that could thus demand

calculate the employer contributions needed to provide the agreed-upon benefits for retirees, but also the premium paid to a government retirement insurance fund (the Pension Benefit Guaranty Corporation) to protect employees of companies that fail to fund their pension liabilities). See also RICHARD A. IPPOLITO, PENSION PLANS AND EMPLOYEE PERFORMANCE: EVIDENCE, ANALYSIS, AND POLICY 85-89 (1997) (arguing that the decline of defined benefit plans owes much to the popularity of Section 401(k) plans, which are not so much cheaper for companies to administer as they enable companies to key retirement benefits to worker productivity); STEVEN A. SASS, THE PROMISE OF PRIVATE PENSIONS 238-46 (1997) (discussing reorganization of big business and arguing that defined contribution plans are more suitable in labor environment where highly-educated employees "rent" their services to many different companies over their working lives, which means that they could not take full advantage of defined benefit plans because of vesting requirements). The negative aspect of this shift is that the defined benefit plans better protect an individual against the risk that he or she will outlive his or her retirement resources in the actual retirement and that he or she will not have the competence to save adequately in retirement or have the market power to make the best investments. See, e.g., E. PHILIP DAVIS, PENSION FUNDS: RETIREMENT-INCOME SECURITY, AND CAPITAL MARKETS: AN INTERNATIONAL PERSPECTIVE 23 (1995). Yet defined contribution plans avoid any unfairness of the defined benefit plans due to the latter's redistributive nature and enable an investor to capture the upside of investment growth and avoid cumbersome eligibility requirements. See RICHARD DISNEY, CAN WE AFFORD TO GROW OLDER? A PERSPECTIVE ON THE ECONOMICS OF AGING 111-21 (1996) (explaining that, in defined benefit plans, older workers benefit at expense of others because they are given early retirement, which typically requires more contributions from younger workers); Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1539-40 (1997) (observing that employers providing defined benefit plans captured most of the 350% gain in pension fund assets from 1980 to 1995 because their pension obligations to employees were fixed).

considerable resources.¹⁴ Second, the main federal retirement program, Social Security, which is really a “pay-as-you-go system” where present workers pay benefits for current retirees, has potential funding difficulties and, in any event, cannot support an adequate retirement for most people.¹⁵ Indeed, many policy discussions and legislative proposals regarding Social Security suggest replacing, partly or entirely, its current defined benefit with a defined contribution approach, that is, allowing at least some of an individual’s contributions to be placed in an individualized account subject to his or her own limited investment decision-making, rather than to be used to pay the Social Security benefits of current retirees.¹⁶

¹⁴ See U.S. GENERAL ACCOUNTING OFFICE, RETIREMENT INCOME: IMPLICATIONS OF DEMOGRAPHIC TRENDS FOR SOCIAL SECURITY AND PENSION REFORM 17 (GAO/HEHS-97-81, July 11, 1997) [hereinafter, GAO RETIREMENT INCOME] (providing chart showing steady longevity increase since 1940 and projected increase in future).

¹⁵ See generally U.S. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY: DIFFERENT APPROACHES FOR ADDRESSING PROGRAM SOLVENCY 12-20 (GAO/HEHS-98-33, July 22, 1998) (describing basic structure of program and funding difficulties caused by lower fertility and increased longevity of “Baby Boom” generation); GAO RETIREMENT INCOME, *supra* note 14, at 40-41; Robert J. Myers, *Will Social Security be There for Me?*, in SOCIAL SECURITY IN THE 21ST CENTURY 208, 209-11 (Eric R. Kingson & James H. Schulz eds., 1997) (summarizing various actuarial reports on date of future deficit in Social Security funds). In the Social Security program (officially, the Old-Age, Survivors, and Disability Insurance (OASDI) program), present workers are taxed to pay for the benefits of current retirees. See Myers *supra*, at 208. Social Security now collects more than it pays out and has generated a surplus that is invested in, and receives interest payments as, U.S. Treasury securities. *Id.* at 209. Under current estimates, Social Security’s surplus will rapidly fall in 2009 and disappear in 2012. *Id.* The federal government will then have to begin repaying Social Security’s loan to it to make up the shortfall. Proceeds from this loan (also known as the Social Security trust funds) will be used up in 2029. *Id.*

¹⁶ See, e.g., GAO RETIREMENT INCOME, *supra* note 14, at 29-41 (listing possible solutions, such as reducing initial benefits, raising retirement age, reducing cost-of-living adjustments, means-testing benefits, increasing income taxes on Social Security benefits, increasing payroll taxes, etc.); U.S. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY FINANCING: IMPLICATIONS OF GOVERNMENT STOCK INVESTING FOR THE TRUST FUND, THE FEDERAL BUDGET, AND THE ECONOMY 4-6 (GAO/AIMD/HEHS-98-74, Apr. 22, 1998) (discussing implications of shifting Social Security trust funds from investing in government securities to stocks); NATIONAL COMM’N ON

This development may, or may not be, for the best. Many individuals may not be competent to plan adequately about an issue that they experience once in their lives.¹⁷ And the literature on individual saving and investing behavior (and on rationality in general) suggests that there are many reasons, including psychological factors, why individuals do not save and invest optimally.¹⁸ Placing such an important issue as retirement planning on individuals' shoulders could lead to significant disparities in retirement income beyond those that naturally flow from differences in pre-retirement income, kinds of jobs and the generosity of an employer's pension plans.¹⁹ Yet, as I argue elsewhere,²⁰ individual saving and investing responsibility will exist in the United States primarily for cultural reasons. The situation is not bleak, because, more so than ever in the past, individuals have a wealth of investment opportunities, primarily because of the

RETIREMENT POLICY, "THE 21ST CENTURY RETIREMENT SECURITY PLAN" 2 (May 19, 1998) (summarizing its reform recommendations on Social Security, which include having individual Social Security accounts with individually-directed investments).

¹⁷ See Richard H. Thaler, *Psychology and Savings Policies*, 84 AM. ECON. ASSN. PAPERS & PROC. 186, 187 (May 1994); see also U.S. GENERAL ACCOUNTING OFFICE, SOCIAL SECURITY: DIFFERENT APPROACHES FOR ADDRESSING PROGRAM SOLVENCY 69 (GAO/HEHS-98-33, July 22, 1998) ("Under a privately managed system of individual accounts, individuals or employers might contract directly with financial institutions. This could mean a wide array of investment choices for individuals and, at the same time, a wide variation in potential financial outcomes.").

¹⁸ See, e.g., Christine Jolls, et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1477-78 (1998) (discussing data calling into question rationality of economic actors); Cass R. Sunstein, *The Future of Law and Economics: Looking Forward: Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1179-92 (1997) (outlining psychological factors that can affect rationality); Thaler, *supra* note 17, at 186-91 (arguing that psychological factors affect investors so that they do not perform optimal life-cycle investing). See generally Matthew Rabin, *Psychology and Economics*, 36 J. ECON. LIT. 11, 24-31 (Mar. 1998) (discussing evidence of biases in decision-making).

¹⁹ That is, giving individuals saving and investing responsibility cannot affect such issues as the enormous disparities in income arising from kinds of employment. Other things being equal, however, it could lead to differences in retirement income that depend upon the amount saved and one's investment strategy.

²⁰ See Fanto, *supra* note 6.

development of mutual funds. The major policy question, therefore, is how to help ordinary people perform optimally their saving and investing responsibilities.²¹

Investor education, one of the central ways of so helping ordinary investors, raises many issues, such as the identity of its provider and the nature of its content. Because this is not the place to explore these theoretical questions,²² it is enough to observe that policy-makers in financial services²³ are clearly focusing on investor

²¹ One problem with a narrow definition of investor education is that it encourages investors to concentrate only on their portfolio and to ignore "larger" social issues relating to company activity. Yet they must acquire this basic financial education, which is critical to their social survival, before progressing to education about "larger" corporate and financial issues. See James A. Fanto, *Investor Education, Securities Disclosure and the Creation and Enforcement of Corporate Governance and Firm Norms*, 48 CATH. U. L. REV. (1998).

²² I have outlined a theoretical model for the kinds and appropriate providers of investor education. See Fanto, *supra* note 6. Economists, most notably Douglas Bernheim, have investigated the efficacy of investor education in different contexts. See, e.g., PATRICK J. BAYER, ET AL., THE EFFECTS OF FINANCIAL EDUCATION IN THE WORKPLACE: EVIDENCE FROM A SURVEY OF EMPLOYERS (National Bureau of Econ. Research Working Paper No. 5655, 1996) (discussing evidence from workplace financial education); B. DOUGLAS BERNHEIM, ET AL., EDUCATION AND SAVING: THE LONG-TERM EFFECTS OF HIGH SCHOOL FINANCIAL CURRICULUM MANDATES (National Bureau of Econ. Research Working Paper No. 6085, 1997) (presenting empirical research on results of high school financial education); B. DOUGLAS BERNHEIM & DANIEL M. GARRETT, THE DETERMINANTS AND CONSEQUENCES OF FINANCIAL EDUCATION IN THE WORKPLACE: EVIDENCE FROM A SURVEY OF HOUSEHOLDS (National Bureau of Econ. Research Working Paper No. 5667, 1996) (presenting empirical research on effects of workplace financial education).

²³ Securities regulators cannot accomplish this task alone. For one reason, they have no jurisdiction over the individual investing that occurs through employer-sponsored defined contribution plans, which the Pension and Welfare Benefits Administration in the Department of Labor oversees under the statutory structure of the Employee Retirement Income Security Act of 1974 (ERISA). See 29 U.S.C. §1104(c) (West Supp. 1998) (authorizing employer to provide defined contribution individual account plan); 29 C.F.R. § 2550.404c-1(b)(3) (1998) (Department of Labor's regulations providing that employer must offer employee minimum of three diversified investment alternatives with different risk and return characteristics). The applicable regulations for such plans require that an employer supply information about the investment alternatives so that employees can make an informed decision, see 29 C.F.R. § 2550.404c-1(c) (1998), and this

education. A recent amendment to the Employee Retirement Income Security Act of 1974 (ERISA), for example, requires pension regulators and associated financial market regulators to develop saving and investing education,²⁴ and the SEC has promoted investor education through the activities of its Office of Investor Education and Assistance, such as the recent "Facts on Saving and Investing Campaign."²⁵ Those in the financial services industry, and their friends, have not waited for policy guidance to engage in investor education, but have created numerous educational products and services in

information can come in the form of disclosure concerning a given investment prepared in accordance with securities regulations. The aid given to individual investors must come, therefore, from many sources, including the government regulator having jurisdiction over the particular kind of investing in question. *See, e.g.*, Participant Investment Education, Interpretive Bulletin 96-1, 29 C.F.R. § 2509.96-1(d) (1996) (establishing a "safe harbor" for four kinds of information and education that employers, and particularly financial firms operating the plans for them, can supply to employees without triggering a fiduciary obligation to them (i.e., without being deemed to be giving investment advice)).

²⁴ *See, e.g.*, Savings Are Vital to Everyone's Retirement Act of 1997 or SAVER Act, which amended ERISA to provide outreach to promote retirement income savings and a national summit on retirement savings. *See* 29 U.S.C. §§ 1146-47 (West Supp. 1998). The SAVER Act states that its purpose is:

- (1) to advance the public's knowledge and understanding of retirement savings and its critical importance to the future well-being of American workers and their families;
- (2) to provide for a periodic, bipartisan national retirement savings summit in conjunction with the White House to elevate the issue of savings to national prominence; and
- (3) to initiate the development of a broad-based, public education program to encourage and enhance individual commitment to a personal retirement savings strategy.

Savings Are Vital to Everyone's Retirement Act of 1997, Pub. L. No. 105-92, § 2, 111 Stat. 2139, 2139 (1997).

²⁵ *See Overview: Get the facts. It's your money. It's your future.*, (visited Oct. 6, 1998) <<http://www.sec.gov/consumer/cosra/about/facts.htm>> (describing week-long, SEC-sponsored "Facts on Saving and Investing Campaign" from March 29 to April 4, 1998 with participation of other government agencies, state securities regulators, consumer organizations and financial industry trade groups). Most recently, the SEC has placed a "Financial Facts Toolkit" on its web site. *See Get the facts. It's your money. It's your future. Financial Facts Toolkit*, (visited Oct. 6, 1998) <<http://www.sec.gov/consumer/toolkit.htm>>.

response to investor demand and, as is most likely, as a way to stimulate this demand.²⁶

Federal financial regulators clearly have a role in investor education. This role involves participating in a national campaign to help change the norms and behavior of individuals regarding saving and investing²⁷ and to

²⁶ Sources of investor educational materials and services are simply too numerous to list. Fund companies, brokers, trade organizations and nonprofit organizations, among others, provide educational materials and services through various media, including the World Wide Web. See, e.g., *Fidelity Investments: Know what you own and know why you own it*, (visited Oct. 6, 1998) <<http://www.fidelity.com/planning/investment>> (providing investment educational materials about importance of saving, particularly for retirement needs, elementary finance, investments, tax-reducing retirement options, mutual funds, investment basics and asset-allocation strategies); *Mutual Fund Connection*, (visited Oct. 6, 1998) <<http://www.ici.org>> (providing general educational materials explaining nature of mutual fund, its risks and benefits (chiefly diversification), kinds of mutual funds, typical fees, expenses and services of funds and pricing and redemption of mutual fund shares); *AARP Webplace*, (visited Oct. 6, 1998) <<http://www.aarp.org>> (web site of American Association of Retired Persons with extensive educational materials); *National Institute for Consumer Education*, (visited Oct. 6, 1998) <<http://www.emich.edu/public/coe/nice/nice.html>> (including educational materials developed with assistance of National Association of Securities Dealers, and hypertext link to free or inexpensive sources of investor education). See generally, Fanto, *supra* note 6 (discussing these private educational materials and services).

²⁷ See Fanto, *supra* note 6. Federal and state government officials need to encourage improved saving and investing by ordinary Americans, so that investing and saving become both optimal and almost habitual. See Hersh M. Shefrin & Richard H. Thaler, *The Behavioral Life-Cycle Hypothesis*, in RICHARD H. THALER, *QUASI-RATIONAL ECONOMICS* 91, 92-101 (1991) (describing usefulness of "habitual rules" in enabling individuals to resist impulses, and explaining prominence of "mental accounts," whereby individuals divide their income and assets into various accounts, some of which are unavailable for current consumption). See generally Assar Lindbeck, *Incentives and Social Norms in Household Behavior*, 87 *AMER. ECON. REV.* 370, 375-76 (1997) (discussing saving and consumption norms that "provide a third important illustration of relations between economic incentives and social norms in the context of household behavior"); Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 *MICH. L. REV.* 338, 351 (1997) (defining "norms" as nonlegal obligations arising within decentralized groups or at societal level); Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 *AMER. ECON. REV.* 365, 365 (1997) ("By 'social norm' ('norm' for short) I shall

educate them on protecting themselves against financial fraud. As part of this activity, they should also consider how they could best work with private parties to develop and deliver investor education.

III. THE EDUCATIONAL IMPORTANCE OF THE PROFILE

The profile initiative, which essentially involves allowing mutual fund companies to sell mutual funds by means of an abbreviated prospectus or profile, raises significant issues for fund companies and legal practitioners in investment management. A central one involves the liability implications of permitting a company to use an abbreviated document, as opposed to the full prospectus, to solicit interest in the fund.²⁸ This Article's analysis of the profile, however, focuses only on its implications for investor education. From this perspective, the profile initiative first exemplifies how investor education should involve a partnership between private firms providing, and experimenting with the design of, educational products and services and government regulators who oversee and promote this activity. Second,

mean a rule that is neither promulgated by an official source, such as a court or a legislature, nor enforced by the threat of legal sanctions, yet is regularly complied with (otherwise it wouldn't be a rule.)" (footnote omitted).

²⁸ The central concern is that a fund company would incur liability by using a profile, which omits material information about the fund that the full prospectus otherwise includes. The company could not rely on the full prospectus in using the profile, because the profile does not incorporate by reference the longer document. Although the profile is a summary or "omitting" prospectus under Section 10(b) of the Securities Act of 1933 that is exempt from the strict liability of Section 11 of the Act, see 15 U.S.C. § 77j(b) (1996), a company could incur liability for the profile under Section 12(a)(2) of that Act or generally under Section 10(b) and Rule 10b-5 of the Securities Exchange Act. See generally Final Profile Release, *supra* note 7, at 13,970-13,972 (discussing liability issues concerning profile); Profile Proposal, *supra* note 7, at 10,950 (same). The SEC believes that fund companies should not incur increased liability for using a profile so long as a profile provides material information (or does not omit such information) required by the line items of the profile format. See Final Profile Release, *supra* note 7, at 13,971-13,972.

the initiative shows, as a general matter, the increasing link between securities disclosure and education because of the renewed focus in securities regulation on effective communication to the ordinary investor. Third and more specifically, by raising key topics that should be on every investor's mind, a profile presupposes on an investor's part some investor training and invites the investor to apply an educational framework to it.

The development of the profile exemplifies how the private sector (a term used broadly to include both "for profit" and nonprofit companies) has often taken the lead in providing investor educational products and services to the ordinary investor. Closer to the consumer than government regulators and responding to the needs of their customers, private firms pay attention to the increased saving and investing responsibilities of ordinary people and their confusion in the face of numerous investment products and services. In particular, mutual fund companies are well situated to observe that the typical investor, whether inside or outside retirement plans, "face[s] an increasingly difficult task in choosing among different fund investments"²⁹ and has limited financial sophistication or "literacy."³⁰ They also realize that, because many of these investors cannot understand, and/or do not have the time to read, the lengthy, financially and legally complex fund prospectuses,³¹ they increasingly look to simple comparisons, evaluations and

²⁹ See Final Profile Release, *supra* note 7, at 13,968 (noting that "[t]he Commission, fund investors, and others have recognized the need to improve fund disclosure documents to help investors evaluate and compare funds.") (footnote omitted).

³⁰ See *id.* (discussing different types of investors). See generally, Henry T. C. Hu, *Illiteracy and Intervention: Wholesale Derivatives, Retail Mutual Funds, and the Matter of Asset Class*, 84 GEO. L.J. 2319, 2358-79 (1996) (observing that mutual fund disclosure laws increasingly require discussion of attributes of *class* of investments to which fund belongs (or in which it invests) and thus leads to issues of investor "literacy").

³¹ See Final Profile Release, *supra* note 7, at 13,970 ("The Commission and others, in seeking to identify ways to improve the disclosure of information about mutual funds to investors, have collected data about investors. This data demonstrates that different investors desire and

ratings of funds offered by market services³² or to the more accessible materials supplementary to a prospectus, such as sales literature and advertisements, supplied by fund companies, to make an investment decision.³³ Accordingly, in consultation with the SEC and the Investment Companies Committee of the North American Securities Administrators Association, the Investment Company Institute (ICI) and eight fund companies developed prototype shorter prospectuses or profiles and tested consumer reaction to them. The tests showed that the shorter documents were popular with consumers and that led to the profile initiative.³⁴

The initiative also demonstrates that a primary focus of securities regulation pertaining to consumer issues is increasingly educational in nature because of an enhanced concern for disclosure's "effective communication" to ordinary investors.³⁵ If the inquiry is whether disclosure is in fact reaching the ordinary

use different types and amounts of materials in determining whether to invest in funds.") (footnote omitted).

³² See, e.g., *The Kaufmann Fund: Morningstar.net*, (visited Oct. 6, 1998) <<http://www.morningstar.net>> (web site of one well-known mutual fund rating service).

³³ See, e.g., Clifford E. Kirsch, et al., *Mutual Fund and Variable Insurance Products Performance Advertising*, 50 BUS. LAW. 925, 933-35, 952-59 (1995) (summarizing advertising laws and regulations and discussing problems with simplified fund prospectuses and fund advertising); Paul S. Stevens & Craig S. Tyle, *Mutual Funds, Investment Advisers, and the National Securities Markets Improvement Act*, 52 BUS. LAW. 419, 425-27, 459-68 (1997) (discussing development of simplified fund disclosure and advertising).

³⁴ See Profile Proposal, *supra* note 7, at 10,944 (describing history of experimentation with profiles by large fund companies); Final Registration Release, *supra* note 8, at 13,918 (same). See generally INVESTMENT COMPANY INSTITUTE, *THE PROFILE PROSPECTUS: AN ASSESSMENT BY MUTUAL FUND SHAREHOLDERS* (1996) (presenting research into consumer attitudes regarding fund profiles to the SEC).

³⁵ See, e.g., Final Registration Release, *supra* note 8, at 13,917 ("Taken together, these initiatives [new fund prospectus format, profile, etc.] are designed to promote more effective communication of information about funds to investors without reducing the amount of information provided to investors. The Proposed Amendments reflected the Commission's strong belief that the primary purpose of the disclosure in a fund's prospectus is to help an investor make a decision about investing in the fund.") (footnote omitted).

investor, one must improve both ends of the communication process, the disclosure itself *and* the comprehension abilities of the investor. The recent focus on the ordinary investor has been a priority of the current SEC Chairman, Arthur Levitt, who has championed such investors in many initiatives, most notably in the "plain English" regulation.³⁶ This emphasis (for it is only that) in securities regulation is necessary as so many new investors enter the securities markets and as the possibilities for their individual investing, through the World Wide Web or otherwise, multiply.³⁷ Even if their expertise traditionally has lain with regulating company disclosure, securities regulators cannot ignore the comprehension of individual investors, for, if it proves to be inadequate, there could be adverse consequences in the securities markets.³⁸

³⁶ Chairman Levitt has clearly been the catalyst for the SEC's educational initiatives: in 1993 he established an Office of Investor Education and Assistance and has conducted town meetings with ordinary investors. See *Permanent Subcomm. On Investigations of the Senate Comm. On Government Affairs*, 105th Cong., 1st Sess. 18 (1997) (statement of Arthur Levitt, Chairman, U.S. Securities and Exchange Comm'n) (describing town meetings as "typically well-attended (often over 1,000 investors attended each meeting) and featur[ing] a series of seminars for investors on a wide variety of topics"). On the SEC "plain English" initiative, see Plain English Disclosure, Securities Act Release No. 7,497, 63 Fed. Reg. 6370 (1998) (establishing "plain English" rules and principles for writing prospectus disclosure); Plain English Disclosure, Securities Act Release No. 7,380, 62 Fed. Reg. 3152, 3155-59 (proposed Jan. 21, 1997) (discussing elements of plain English in proposed rule). See generally Fanto, *supra* note 6.

³⁷ See, e.g., Peter Galuszka, *Guess Who's Courting the Beardstown Ladies?*, BUS. WK., Sept. 22, 1997, at 90 (discussing direct investment movement and National Association of Investors Corporation which encourages this movement and educates investors); Barbara Hetzer, *Direct Stock Buying: A Load of New No-Loads*, BUS. WK., June 16, 1997, at 152 (explaining that individual investors have increasing opportunities to buy stock directly from public companies and thus bypass brokers).

³⁸ Cf., FRANKLIN R. EDWARDS, *THE NEW FINANCE: REGULATION AND FINANCIAL STABILITY* 123-24 (1996) (describing concern that investors could panic in market downturns and upset market structure). Of course, during the high market volatility of recent months, all eyes have rested on ordinary investors to see whether, in fact, they will panic and bring about a market crash as some commentators have speculated.

In its profile releases, the SEC affirms that the central purpose of the profile is to ensure that funds are communicating effectively to ordinary investors.³⁹ The profile initiative compels companies to present essential information about themselves in a simple way so that an investor who has little time and, even more importantly, little investment sophistication can understand it.⁴⁰ The profile does this in an obvious way by encouraging fund companies to use attractive graphic presentations and charts, to avoid dense textual descriptions and thus to make the profile an inviting document to read.⁴¹ A fund can provide in the profile only nine items of information in a set order (and several of these involve a chart or table presentation)⁴² so that an ordinary investor receives only limited, key information about a fund in a simplified format. The final release invites fund companies to experiment with presentation devices (such as, question-and-answer format) that will further enhance the comprehensibility of these items.⁴³ Part of effective communication involves access to profiles, and a fund company can distribute them to consumers widely

³⁹ See Final Profile Release, *supra* note 7, at 13,970 ("the Commission encourages all funds that decide to use profiles to take the steps necessary to ensure that their prospectuses effectively communicate information to investors").

⁴⁰ See *id.* ("The Commission's strongly held belief is that the principal goal of fund disclosure, whether it takes the form of a long or short document, should be to provide investors with useful and relevant information.").

⁴¹ See *id.* at 13,985. A fund company must prepare a profile using the "plain English" writing principles, as now incorporated at 17 C.F.R. § 421(d) (1998). See Final Profile Release, *supra* note 7, at 13,969-13,970, 13,972.

⁴² See Final Profile Release, *supra* note 7, at 13,972.

⁴³ In the rule proposal, the SEC would have required that a fund present the items in a question-and-answer format that was popular with consumers in focus groups who were the subjects of experimentation with the profile. See Profile Proposal, *supra* note 7, at 10,945 ("The proposed question-and-answer format, frequently used by many funds, is intended to help communicate the required information effectively."). To allow for continued industry developments with profile presentation, the SEC omitted this requirement from the final release, but kept the requirement that the nine items be presented in a set order. See Final Profile Release, *supra* note 7, at 13,972.

through various media, including through mass mailing, newspapers and electronic delivery.⁴⁴ In fact, the SEC recognizes the suitability of the profile to the growing Internet use by fund companies and fund customers because a company can electronically provide a profile and then “hypertext link” it to the full prospectus and other information about the fund.⁴⁵

The most important aspect of the profile initiative is the way it encourages an investor to use whatever investor education he or she has received. The central purpose of investor education is to teach an investor the basics of finance and investing so that he or she becomes part of the investment “culture.”⁴⁶ This means that an investor must learn about the basic kinds of investments (including about the securities markets in which they trade and the regulation of those markets) and investment professionals. An investor must also learn to locate information about investment performance (and acquire the ability to understand the conventions of presentation of this information).⁴⁷ Even more importantly, he or she must learn the relation of risk to return, the means of minimizing or eliminating certain risks (such as, through diversification) and some fundamentals about investing

⁴⁴ See *id.* at 13,981.

⁴⁵ See Profile Proposal, *supra* note 7, at 10,951 n.94 (noting that profile is especially effective in Internet dissemination because of ability to hyperlink to prospectus from profile). See also Final Profile Release, *supra* note 7, at 13,980-13,981. On electronic delivery of disclosure documents, see generally HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE 2-1 to 3-42 (2nd ed., 1998). The profile initiative also permits fund companies to tailor profiles used in employer-sponsored retirement plans (such as those under Section 401(k)) to the plan's needs and participant investment limitations. See Final Profile Proposal, *supra* note 7, at 13,981-13,982 (permitting omission of information relating to purchases and sales of fund shares, fund distributions and tax consequences).

⁴⁶ See Fanto, *supra* note 6.

⁴⁷ An example of this “standardized” investing education is in NATIONAL INSTITUTE FOR CONSUMER EDUCATION, THE BASICS OF INVESTING: A GUIDE FOR EDUCATORS, at Unit 2 (“How Financial Markets Work: Lesson 1-Types of Financial Markets”), Unit 3 (“Investment Choices: Lesson 2-Types of Savings and Investments”) (1997) (also available at <<http://www.emich.edu>>).

strategy. In order to create an optimal portfolio, an investor needs to know how to make a correct asset allocation in line with his or her life stage and investment goals (that is, life-cycle investing) and the way to choose among comparable investments, taking into account such factors as expenses and tax consequences.⁴⁸

The profile's content, which uses disclosure items from the revised fund prospectus,⁴⁹ gives investors the above kinds of information. A fund profile must summarize the fund's basic investment objectives and the general strategies of its advisor for achieving them, such as, that an equity fund adopts a "growth" approach and that it attains this objective through purchases of securities of companies with specific characteristics.⁵⁰ With such an identification, an investor can consider whether an investment in a fund is appropriate in light of his or her portfolio objectives. A profile's risk disclosure requires a fund to identify in general terms the specific risks to which it is subject because of its portfolio, objectives and strategies, as well as to provide a bar chart of annual total returns over a ten-year period and a table indicating the fund's average annual returns for one-, five- and ten-year intervals.⁵¹ Such disclosure encourages an ordinary

⁴⁸ See Fanto, *supra* note 6.

⁴⁹ The profile would alert investors that they could obtain from the company a full prospectus (which, in any event, would be sent to them upon confirmation of purchase). See Final Profile Release, *supra* note 7, at 13,969. See also Profile Proposal, *supra* note 7, at 10,944 ("The profile would allow investors to choose the amount and format of information they want before making an investment decision.").

⁵⁰ See Registration Proposal, *supra* note 8, at 10,910 ("The information might describe, for example, whether an equity fund emphasizes value or growth, or blends the two approaches, or whether the fund invests in stocks based on a 'top-down' analysis of economic trends or a 'bottom-up' analysis that focuses on the financial condition and competitiveness of individual companies."); at 10,902 (requiring fund to disclose whether it intends to concentrate on particular kinds of securities and/or on industry or group of industries). See also Final Registration Release *supra* note 8, at 13,920.

⁵¹ See Final Registration Release, *supra* note 8, at 13,919, 13,948-13,949; Registration Proposal, *supra* note 8, at 10,903. A fund must also present the best and worst returns for a quarter during this ten-year period so as to indicate the extreme range of volatility in a

investor to think about the relationship between risk and return in a fund (that is, that a greater return comes with greater volatility) and the appropriateness of such an investment given his or her risk profile. A fund must also provide disclosure relating to the kinds and amounts of mutual fund fees (a subject attracting increasing regulatory attention⁵²), which includes a standardized example showing the accumulated costs of a fund for one-, three-, five- and ten-year intervals.⁵³ This presentation allows investors to compare funds on the important issue of their costs, as well as their performance.⁵⁴

Indeed, the prominence that educationally important information receives in a profile can almost cause a fund to conduct some investor education itself. In discussing a fund's risks, a fund may, but is not required to, identify the kind of investor for which it is suitable, depending upon the investor's risk tolerance and preferences.⁵⁵ A

fund. See Final Profile Release, *supra* note 7, at 13,977; see also Registration Proposal, *supra* note 8, at 10,911 & n.136 (explaining that fund companies disagreed about appropriate quantitative risk measurement standards and about the ability of consumers to understand and to use effectively quantitative risk measurement, which led the SEC not to impose any such risk disclosure requirements). This Article does not discuss the technicalities of return/risk presentation (e.g., for funds with a shorter than ten-year life).

⁵² See, e.g., Arthur Levitt, *Remarks at the Investment Company Institute* 3-4 (May 15, 1998), available at <<http://www.sec.gov/news/speeches/spch212.txt>>; Pension and Welfare Benefit Administration, *Study of 401(k) Plan Fees and Expenses* (Apr. 13, 1998).

⁵³ See Final Registration Release, *supra* note 8, at 13,949-13,951.

⁵⁴ The other profile items involve disclosure relating to (i) a fund's investment adviser, (ii) the purchase of fund shares, (iii) the sale of fund shares, (iv) fund distributions and their taxation and (v) other fund services. See Final Profile Release, *supra* note 7, at 13,986.

⁵⁵ See Final Profile Release, *supra* note 7, at 13,975-13,976; Final Registration Release, *supra* note 8, at 13,921. The original proposal required that funds identify appropriate investors. See Registration Proposal, *supra* note 8, at 10,903 (providing that risk section would include disclosure of types of investors for whom the fund may be appropriate). In response to opposition by commenters who thought that the requirement would conflict with suitability rules imposed on brokers and investment professionals (i.e., that brokers must determine whether an investment is suitable for a client), the SEC made identification optional in the new registration form and profile (although it encouraged funds to make the identification).

fund company cannot do this disclosure properly without educating an investor about asset-allocation and life-cycle decision-making. A growth fund may explain that its "ideal" investor has a long-term investment horizon and no immediate need for funds and may additionally point out that this investor is typically a younger person with years of future earning potential who has no near-term need of funds from investment return (echoing life-cycle asset allocation that would tell such a person to weight his or her portfolio heavily toward growth stocks). A risk disclosure requirement that a fund's bar chart of risk/return information compare the fund's annual returns for one-, five- and ten-year intervals to those of an appropriate market index encourages⁵⁶ investors to compare a fund's performance to that of other funds and particularly to a market index. If a particular fund is actively managed, this comparison, together with the cumulative cost disclosure, invites an investor to consider whether investing in the fund would be better or worse than following a passive indexing investing strategy.⁵⁷

⁵⁶ See Final Registration Release, *supra* note 8, at 13,922-13,924.

⁵⁷ See, e.g., MALKIEL, *supra* note 4, at 422-32 (describing benefits of index strategy); at 441-46 (addressing why some money managers consistently outperform market indices). The SEC proposal regarding investment company names may have even a more basic educational effect when used in conjunction with the profile because it will protect an investor's application of educational principles to fund investing. This proposal, promulgated pursuant to the National Securities Markets Improvement Act of 1996, which amended Section 35(d) of the Investment Company Act of 1940 to empower the SEC to address deceptive or misleading company names by its rule-making authority, see National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 208, 110 Stat. 3416, 3432 (1996), would require that a fund invest at least 80% of its assets in a specific kind or kinds of securities if its name suggests a fund focus on them (the SEC currently takes the position that a fund invest 65% of its assets in securities of the kind indicated by the fund's name). See Names Proposal, *supra* note 8, at 10,956. In the proposal, the SEC explains that consumers increasingly use investment companies to meet their retirement and other investment needs and base their fund investments on asset-allocation theory—a primary component of investor education. See *id.* at 10,956-10,957. In allocating their money, they use well-defined kinds of funds, such as stock, bond and money market funds, to meet their target portfolio composition. Yet, in the SEC's view, investors rely too much on fund names. See *id.* at 10,956. Therefore, if a mutual fund

IV. FURTHER EDUCATIONAL POSSIBILITIES FOR THE PROFILE

The investor education features of the profile initiative help ordinary investors, particularly regarding mutual fund investing. Yet the SEC should expand this initiative, partly by having funds encourage investors, by means of profile items, to pay more attention to the basics of investing. More importantly, the SEC should allow, and even consider requiring, fund companies expressly to link profiles to educational materials developed by them, or by industry or nonprofit organizations. This link will further stimulate an investor to consider, and to integrate into his or her decision-making, the important educational issues so essential to optimal investing. To do this, the SEC must explicitly recognize (as it is starting to do) the importance and value of educational products and services of private organizations.

With an appropriate change to the rule governing the profile, a mutual fund company could conduct more education in the profile itself (or in the fund prospectus). For example, a fund company could explain how a particular fund would fit into an asset-allocation strategy and what, in fact, this strategy means. Although a possible problem with this approach is that it forces a company to spend too much time hypothesizing about the identity of the typical investor and his or her need for information and education, the current regulatory solution in fund disclosure, which is sensible, is to design disclosure for an investor who has little training or sophistication in investing.⁵⁸ The main difficulty with putting education in the profile is that it would threaten to expand the profile, and even a full prospectus, beyond its intended scope. The profile is designed to be a short document (or "virtual"

implies through its name that it specializes in particular investments, but does not in fact do so, it undermines the beneficial effects of investor education.

⁵⁸ See Final Registration Release, *supra* note 8, at 13,919 ("Funds should limit disclosure in prospectuses generally to information that is necessary for an average or typical investor to make an investment decision.").

document) that provides only the *basic* information (that is, the nine items stipulated by the profile rule) that an investor needs to make an investment decision, which involves comparing funds on performance and costs. The profile must, therefore, be kept short because investors are reluctant to read a lengthy document (as the Names Proposal implies, they often read only the name of a fund!).⁵⁹

The SEC could, however, enhance the educational focus or compatibility with investor education of some profile disclosure items. A good example, as discussed above, is that a fund indicate the kind of investor for which it is appropriate. This reference, which need not be long, can convey the information to which an investor could apply the basic asset-allocation, life-cycle strategy that he or she should have learned in an investor education program, or at least alert an investor to find out about this strategy. Indeed, profiles presenting a family of funds for different stages in a life cycle would be particularly useful places to include this discussion because they could key funds to different kinds of investors.⁶⁰ In allowing fund companies to present multiple funds in a profile, the SEC thus enables the presentation of information that truly invites the investor to apply the life-cycle perspective.⁶¹ Even without an explicit SEC requirement (and without

⁵⁹ See Names Proposal, *supra* note 8, at 10,956 ("Congress reaffirmed its concern that investors may focus on an investment company's name to determine the company's investments and risks ...").

⁶⁰ There is, for example, Vanguard's LifeStrategy Portfolios, designed for different life-cycle stages. See THE VANGUARD GROUP, VANGUARD LIFESTRATEGY PORTFOLIOS: ANNUAL REPORT (Dec. 31, 1997). Such educational aid might not be of use to everybody and would hardly substitute for a broker or financial planner who could assess an individual's total financial position and recommend appropriate investments to create an optimal portfolio. If, however, an investor is following a simple life-cycle asset-allocation model and has few investment assets other than his or her portfolio, it would be of use to him or her to know where a fund would fit into a typical portfolio.

⁶¹ See Final Profile Release, *supra* note 7, at 13,973 ("The Commission believes that the ability to describe different investment options in one summary document will enable funds to develop profiles that help investors compare investment alternatives offered by a fund group.").

undermining broker suitability requirements),⁶² it makes sense for fund companies to give some indication to prospective buyers about who is a suitable investor for a particular fund.

A fund company should not have to do more investor education in the profile itself, other than what is suggested above, because the company is likely already providing such education, directly or indirectly through an organization like the ICI, outside the profile. It would thus be unnecessary to require a fund company to repeat its educational product in each of its profiles. Yet this coexistence of educational services with the profile (and, in the case of products available on a fund's web site, the "virtual" proximity of these services to the profile)⁶³ points to the most significant improvement to the profile initiative that the SEC could make by further amendment to its new profile rule. The profile format invites an ordinary investor to apply a basic investing education to the standardized fund information; the fund company has extensive materials and services providing this education. The obvious need is to link the two together.

The SEC should thus take the additional regulatory step of allowing—perhaps even requiring—a mutual fund to link the profile to investor education materials supplied by the fund or by some other financial intermediary or organization. By connecting a profile to educational materials, a fund company would drive home to an ordinary investor that he or she needs the education to make more sense of the simplified fund information and to invest optimally. In fact, linkage between the information and education would work particularly well electronically, which is how many ordinary individuals are increasingly

⁶² See generally NORMAN S. POSER, *BROKER-DEALER LAW AND REGULATION* 2-1 to 2-110 (2d ed. 1997) (discussing fiduciary obligations of brokers).

⁶³ See, e.g., *Fidelity Investments: Know what you own and know why you own it*, (visited Oct. 6, 1998) <<http://www.fidelity.com/planning/investment>> (providing online service where individual account information co-exists with educational information and access is a mouse-click away).

investing.⁶⁴ In such cases, the linkage would occur throughout a profile: when, for example, a fund discusses its risks and identifies the appropriate kind of investor for the fund, it could point the investor by a hypertext link specifically to educational materials on risk, asset allocation and life-cycle investing.⁶⁵ Even if an investor relies on a written profile, a fund could accompany it with a basic investor education booklet to which the profile could be cross-referenced, just as funds now send an investor a handbook on fund services to accompany a profile or a prospectus.⁶⁶

With industry consultation, the SEC must work out the details of the linkage, which means that it would need to submit an amending rule proposal regarding the profile and the new prospectus format.⁶⁷ An obvious concern would be how to introduce an investor to the need for education and to provide cross-references without adding to the size or complexity of the profile. The SEC would have

⁶⁴ See YANKLOVICH PARTNERS INC., 1997 ANNUAL SIA INVESTOR SURVEY: INVESTORS' ATTITUDES TOWARDS THE SECURITIES INDUSTRY 12 (Nov. 1997) (referring to growing numbers of investors who use personal computers to obtain investment information and to trade).

⁶⁵ In all its disclosure simplification initiatives, the SEC worries about confusing a consumer by providing cross-references. Yet the electronic delivery of disclosure documents and educational materials, with their hypertext links, ensures that the use of cross-references does not impede reading and comprehension, because a reader can access them so easily and then return without difficulty to the main document.

⁶⁶ Funds now send investors such educational booklets. See, e.g., CHARLES SCHWAB, THE ESSENTIAL INVESTOR (1997); FIDELITY INVESTMENTS, MANAGING RISK IN YOUR PORTFOLIO: A FIDELITY GUIDE FOR EXPERIENCED INVESTORS (1995) (describing risk, risk management and asset allocation); MERRILL LYNCH, YOU AND YOUR MONEY: A FINANCIAL HANDBOOK FOR WOMEN INVESTORS (1997); THE VANGUARD GROUP, THE VANGUARD INVESTMENT PLANNER: A GUIDE TO ASSET ALLOCATION (1996). The SEC understands and accepts that a fund might send a handbook that supplies information about multiple funds together with a profile or prospectus. See Final Registration Release, *supra* note 8, at 13,954 (explaining how fund can separate out fund purchase and redemption information in separate document, incorporate it by reference in prospectus and distribute it to investors).

⁶⁷ The SEC might also issue a concept release on investor education. See Fanto, *supra* note 6. The SEC could make this proposal regarding the linkage in its concept release.

to draft a simple legend, in "plain English," to be placed at the beginning of the profile, that encouraged investors to use a company's educational materials and services, and it would also have to identify the key items, and appropriate language, for educational cross-references. The logical items for such cross-reference are those involving a fund's objectives, strategies, risks and returns, and fees (the first four profile items). In addition, the SEC will want a fund to make some reference to the SEC's own anti-fraud education materials and to the availability of education providers unaffiliated with the fund. One possible legend incorporating all such educational references would be the following:

You should decide whether an investment in the [fund] is suitable to your personal circumstances and fits with your other investments. For help in making this decision, you should consult your broker or financial advisor, if you have one, and the investor education materials of [fund company], which are available at [provide reference/web site link] and to which this profile will occasionally refer. The Securities and Exchange Commission will also direct you to other education providers, as well as help you protect yourself against investment fraud and abuse (please call [telephone number] or go to the Commission's Internet site, www.sec.gov).⁶⁸

And the SEC would have to consider providing companies with a "safe harbor" from any liability for the educational

⁶⁸ The new disclosure format has reduced the "clutter" of legends and cross-references in the fund prospectus, but still provides for some general ones pointing investors to other documents. *See, e.g.*, Final Registration Release, *supra* note 8, at 13,948 (providing legends that refer investors outside prospectus to fund's annual and semi-annual reports, Statements of Additional Information and even to SEC web site). If a fund company does not provide educational services, it could link its disclosure documents to the services of the ICI or of the brokerage firms through which the fund is sold. *Cf., id.* (allowing a fund sold through a broker to indicate that further information about the fund is available with the broker or another financial intermediary).

materials, for fund companies would be reluctant to make educational references if it enhanced their liability risks.⁶⁹

The SEC has begun to recognize the value of private educational services provided by fund companies.⁷⁰ Additional profile reform in line with the above suggestion could be a significant opportunity for the SEC publicly to acknowledge the developments in investor education by financial firms and nonprofit organizations and to encourage consumers to use these educational services. As such, the reform would fit well in the national campaign relating to investor education on pension investing and the SEC's own recent efforts to improve the position of ordinary investors in the securities markets.

V. CONCLUSION

The current focus on investor education is necessary in this country as individuals bear the responsibility for their retirement future through their own saving and investing. It is not known how much education will improve the investing performance of ordinary investors, and educational efforts should not foreclose other ways of helping Americans (particularly those with lower incomes) prepare for retirement. If, however, education is not effective, the consequences may indeed be grim, as wealth disparities increase through generations and as other, more politically charged solutions might be needed to address the plight of the elderly in retirement. Moreover,

⁶⁹ Cf., 15 U.S.C. § 77b(a)(10)(a) (1997) (exempting supplementary sales literature from the prospectus definition); 17 C.F.R. § 230.135a (1998) (providing that generic advertising for mutual funds will not be deemed to offer security for sale when certain conditions are met). The most sensible approach might well be to exempt educational materials from the definition of a prospectus.

⁷⁰ See Levitt, *supra* note 36, at 2 (praising publicly the educational activities of private firms); Rachel Witmar, *SEC Wants Mutual Funds Voluntarily To Disclose Risk, Fee Data, Barbash Confirms*, 30 SEC. REG. & L. REP. 1006, 1007 (No. 27, July 3, 1998) (reporting that then SEC Director of Investment Management Barry Barbash (as well as Mike Miller of Vanguard) "focused on the need to educate investors beyond the prospectus and other official fund documents, through brochures, the Internet, and the media").

the need for investor education for the ordinary investor is a salutary reminder to those who focus exclusively on institutions in the securities markets and on pension fund capitalism.⁷¹ Behind those institutions stand ordinary investors who place money in a 401(k) plan, an individual retirement account or a brokerage account and must decide how to invest it. If such investors lose confidence in the markets, the impact could be tremendous.

Financial regulators like the SEC have, therefore, no choice but to consider investor education in all of their regulations affecting ordinary investors, even if it presents new challenges to them. This Article argues that, in its profile initiative, the SEC exhibits the appropriate educational focus by adopting a simplified format, the profile, for presenting fund information, by encouraging fund companies to conduct some education in their profile disclosure, and, most importantly, by having them present information that invites the investor to apply to it investor education principles. Because so many fund companies, fund organizations, nonprofit groups and even the SEC itself now provide educational materials and services, the SEC should simply take the next step and facilitate the connection between the profile and these educational materials. To do so would promote the education that ordinary investors so desperately need.

⁷¹ See, e.g., MICHAEL USEEM, *INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA* (1996) (in a discussion of the relations between public corporations and their shareholders he all but dismisses the ordinary investor).