NR 96-77

For Release Upon Delivery
10:00 a.m., June 26, 1996

TESTIMONY OF
EUGENE A. LUDWIG
COMPTROLLER OF THE CURRENCY

Before the
SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES,
AND GOVERNMENT-SPONSORED ENTERPRISES

of the
COMMITTEE ON BANKING AND FINANCIAL SERVICES
of the
U. S. HOUSE OF REPRESENTATIVES

June 26, 1996

Statement required by 12 U.S.C.   250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to testify on the retail sale of mutual fund investments by banks. Bank trust departments have acted as investment advisors, transfer agents, and custodians for mutual funds for more than twenty years. More recently, commercial banks have expanded their retail sales of mutual funds. Overall, mutual funds today play a larger role in the investment portfolios of Americans than several years ago. In fact, total mutual fund assets now exceed total deposits of the commercial banking system. This milestone signifies a fundamental change in the way Americans save.
Banks had little choice but to become more involved in the mutual fund industry if they wanted to continue serving the financial needs of their customers.

The Office of the Comptroller of the Currency (OCC) has monitored closely the rapid growth in bank mutual fund retail sales. Our efforts in dealing with bank retail sales of mutual funds are an important part of my commitment to keep the OCC at the forefront of bank supervision. One of

the first steps during my tenure as Comptroller was to improve disclosure
by national banks to purchasers of mutual funds -- specifically that banks
do not guarantee mutual funds, that these funds are not insured by the
FDIC, and that investors in mutual funds could lose principal. To
accomplish this goal, we undertook several initiatives.

In addition, the OCC has sought more information about mutual fund
investors' familiarity with the costs and investment risks of mutual
funds. In 1995, the economics staffs of the OCC and the Securities and
Exchange Commission (SEC) jointly conducted a survey of 2,000 investors to
assess their understanding of the risks and expenses associated with
mutual funds. The survey found that the vast majority of investors knew
they could lose money in some kinds of mutual funds, although many did not
fully appreciate the relationship of fund expenses to fund returns. There
was virtually no difference in this finding between investors who
purchased mutual funds from banks and those who purchased from nonbanks.
Bank investors generally had the same level of knowledge about the risks
and expenses of mutual funds as other investors, despite the fact that the
survey also found that bank investors were generally older and less well
educated than those who purchased mutual funds from other distribution
channels.

The OCC and other regulatory agencies have taken steps to improve customer
disclosure by banks about the risks inherent in nondeposit investment
products. But we have learned from the joint OCC/SEC economists' study
that the issue extends beyond disclosure. Those with an interest in the
well-being of American savers, including banks and other sellers of
nondeposit investment products, should educate mutual fund customers about
the nature of their investments. The OCC is interested in undertaking
initiatives to improve mutual fund customers' understanding. We welcome
opportunities to work with other agencies to address this need.

My testimony today will address several topics. I will begin by
discussing the remarkable growth in mutual funds over recent years. Next,
I will summarize OCC efforts since 1993 to improve our supervision of bank
mutual fund sales activities and improve customer disclosure by banks.
Finally, I will review the results of the OCC and SEC economists' recent
ground-breaking research on mutual fund investors' characteristics and
level of knowledge about the risks of mutual fund investments.

Trends in Mutual Fund Sales

Total assets of open-end mutual funds have grown rapidly over the years.(1) As Table 1 shows, total assets of open-end mutual funds more than doubled from $1.4 trillion in 1990 to almost $3 trillion at year-end 1995.(2)

TABLE 1:
Total Assets of Open-End Mutual Funds
Dollars in Billions

	1990	1991	1992	1993	1994	1995
Total Industry	1,066.8	1,395.5	1,646.3	2,075.4	2,161.5	2,820.3
Equity Funds	245.8	411.6	522.8	749.0	866.5	1,269.0
Bond Funds	322.7	441.4	577.3	761.1	684.0	798.3
Money Market	498.3	542.5	546.2	565.3	611.0	753.0

The rapid growth in mutual fund assets reflects the increasing demand for this type of investment by consumers. In comparison, total deposits for the commercial banking system were slightly more than $3 trillion at year-end 1995, and grew just 14 percent since 1990. As shown in Figure 1, by the end of the first quarter of 1996, total mutual fund assets surpassed commercial bank deposits.(3)

____

1. Open-end mutual funds can be redeemed on demand by the issuing company. Total assets at closed-end funds were $126.1 billion at year-end 1995.

2. Source: 1996 Mutual Fund Fact Book, Investment Company Institute.

3. Sources: Call Reports and Investment Company Institute.

(Figure 1 attachment)

One reason for this shift in investments is the differential in the rate of return. In recent years, as the interest rates paid on bank deposits have declined, investors have sought alternative investments, such as mutual funds, to improve their rate of return. Changing demographics are another key factor driving this shift: the aging population is saving for retirement. In fact, retirement assets as a percentage of total fund

assets increased from less than 10 percent in 1980 to more than 26 percent in 1994.(4)

(Figure 2 attachment)

Bank mutual fund sales also have grown rapidly in recent years. The regulators started collecting data on mutual fund sales in 1994, and more than 2,000 banks now report mutual fund sales on their Call Reports. Figure 2 shows Call Report data demonstrating the upward trend in bank mutual fund sales.

Assets of mutual funds sold through banks more than quadrupled from 1990 through year-end 1995, growing from $86 billion to $394 billion, as noted in Table 2.(5)

TABLE 2:
Assets of Mutual Funds Sold Through Banks
Dollars in Billions

	1990	1991	1992	1993	1994	1995
Total	85.9	119.7	158.8	219.4	312.8	393.6
Equity Funds	6.0	12.6	20.8	43.2	68.4	96.0
Bond Funds	3.8	8.9	18.9	30.4	34.4	39.8
Money Market Funds	73.0	91.5	111.0	133.8	181.4	225.1
Municipal Debt	3.0	6.7	8.1	11.9	28.7	32.7

____

4. Source: Investment Company Institute.
5. Source: Lipper Analytical Services, Inc., 1995. Assets of mutual funds sold through banks includes funds offered primarily to bank customers, customers of correspondents or affiliates of the bank or bank affiliate advising or administering the funds. Furthermore, these figures exclude bank mutual fund assets invested through fiduciary accounts and trust departments.

The composition of funds sold through banks differs from the composition of funds sold through all channels. At year-end 1995, money market funds accounted for over half of the total assets of mutual funds sold through banks, but only one-quarter of the total assets sold through all channels. Equity funds constituted nearly half of the total assets of open-end mutual funds, but only one-quarter of the assets of mutual funds sold through banks. Nevertheless, since 1990 equity funds have constituted an increasing percentage of mutual funds sold by banks.

The assets of mutual funds sold by banks remain a small percentage of

total mutual fund assets -- only 14 percent at year-end 1995, up from 8 percent at year-end 1990. Figure 3 compares total industry mutual fund assets with assets of mutual funds sold by banks.

(Figure 3 Attachment)

OCC Mutual Fund Activities

This rapid growth in the assets of mutual funds sold through banks and particularly the growing importance of mutual funds in consumers' portfolios raises concerns about bank customers' understanding of the risks of mutual funds and banks' responsibilities related to their sales
activities. The OCC has been at the forefront of efforts to address these
concerns. We concentrated our efforts first on improving bank disclosure
practices. We accomplished this by issuing comprehensive guidance to banks, and working directly with banks through examinations and voluntary
efforts. In addition, we provided information directly to consumers. The
discussion below highlights the OCC's involvement with respect to nondeposit investment sales at banks, the topic of the second question in
your letter of invitation, and our assessment of how well banks are providing customers information about the risks inherent in these products, the topic of the fourth question.

Also, you expressed interest in the organization of the sales delivery function of nondeposit investment products at banks. As described below,
because the overwhelming majority of bank sales are handled by registered
broker/dealer subsidiaries, affiliates, or independent third party vendors, rather than directly by the bank, we coordinate certain

____

6. Sources: 1996 Mutual Fund Fact Book, Investment Company Institute, and Lipper Analytical Services, Inc., 1995.

regulatory activities with the National Association of Securities Dealers (NASD). We also coordinate certain regulatory activities with the SEC. Shortly, we and the other bank regulators will publish a proposal to require those who sell mutual funds at banks to pass the same tests required of other mutual fund brokers -- this is the topic of your third question in the invitation letter. I will describe these undertakings generally in chronological order.

Banking Circular 274. In July 1993, we issued Banking Circular 274, which provided guidance on the retail sale of mutual funds and other nondeposit investment products by banks and through third party vendors. We required banks to develop programs and procedures addressing their nondeposit investment sales activities to apprise customers fully of the nature of these investments. Specifically, we said that banks should make the following product disclosures conspicuously: that the products offered are not FDIC-insured, are not obligations of the bank, are not guaranteed by the bank, and involve risks, including the possible loss of principal. We believe that following this guidance is not only good for consumers but also good business practice for banks. It helps them do a better job of informing customers and protects the bank from events that might damage their reputation.

Interagency Guidelines. Shortly after issuing Banking Circular 274, we began working closely with the other federal regulators of banks and thrifts to develop interagency guidelines covering all aspects of a bank's retail sales operations for nondeposit investment products. The OCC, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), and the Office of Thrift Supervision (OTS) released the Interagency Statement on Retail Sales of Nondeposit Investment Products in February 1994, which superseded Banking Circular 274. In that statement we clarified that banks should view customers' interests as critical to all aspects of their sales programs and emphasized that the federal banking regulators will act to address unsafe and unsound banking practices and violations of law and regulations associated with bank sales of mutual funds and other retail nondeposit investment products.

To minimize customer confusion between insured and uninsured products, the Interagency Statement contains the following specific guidelines. First,

the same disclosure and advertising guidelines as Banking Circular 274 should apply. Second, as part of an effort to take steps to distinguish between retail deposit-taking and retail nondeposit sales functions, bank tellers and other bank employees working in a deposit-taking area such as the teller area should not sell uninsured investment products or offer investment advice. Third, the statement provides that the sales location should be distinct from the deposit-taking area. Fourth, because of the potential for customer confusion, a bank should not offer investment products with a name identical to that of the bank. The interagency guidance also addresses the supervision and training of staff who recommend and sell investment products, compensation for staff, the need to ensure that investment products recommended by the bank are appropriate for each individual customer, and the need for the bank to have an effective compliance program.

In response to questions about the Interagency Statement, the OCC, the FDIC, the FRB, and the OTS coordinated a response to the banking and thrift industries. On September 12, 1995, we issued a joint letter to the American Bankers Association (ABA) and other industry trade groups that clarified further certain activities covered by the Interagency Statement. The OCC sent a copy of that response to all national banks and examiners as well.

This spirit of interagency cooperation continues. We are joining the other bank regulatory agencies to explore the initiatives discussed by Chairman Helfer here today. We are committed to continue working with the other agencies on issues related to bank sales of nondeposit investment products.

Revised Examinations. Also in 1993, the OCC developed a program of mutual fund examinations and issued draft examination procedures to ensure that national banks complied with our guidelines. In August 1993, we began to train our examiners in these draft procedures. Based on the experience we gained in using the draft procedures, we issued examiner procedures in February 1994 on retail nondeposit investment products, including mutual funds. During 1994, the OCC provided extensive training to examiners on the Interagency Statement and the examination guidelines and procedures we issued. Using these procedures, examiners review a bank's business plan

and the policies and procedures governing its mutual fund operations; its compliance with OCC guidelines; its response to any criticism that the OCC made in previous examinations; and its compliance with other applicable laws, rules, regulations, and regulatory conditions imposed by the OCC.

In particular, examiners perform an analysis of a national bank's disclosures and advertising to determine the conspicuousness of disclosures in all written advertising and promotional materials, and documents indicating the nature of oral disclosures. Our examiners review the bank's advertising to ensure that sales advertisements are accurate, do not mislead customers about the nature of the product, and include required disclosures. Examiners also review the processes that banks have in place for areas such as suitability, product selection, compensation, training, sales' setting and circumstances, compliance, and oversight of any third party vendor selling on the bank's premises.

In your invitation letter, you asked specifically about the results of our examinations, in terms of banks' compliance with disclosure requirements.
In 1995, to assure examination consistency, the OCC implemented a Quality Assurance Program (QA) for its nondeposit investment product examinations.
QA task force members reviewed examination results for 534 nondeposit investment product examinations completed during 1995.

The QA Program required lead examiners of each nondeposit investment product examination to report their findings to the QA task force and discuss the type of follow-up action they planned to recommend to bank management. Regarding bank compliance with the Interagency Statement, the findings indicate that the Interagency Statement has been an effective supervisory tool. For the most part, banks are complying with the disclosure section of the Interagency Statement. This shows improvement from the prior year. Where examiners have noted noncompliance, banks generally are taking appropriate corrective action.

For the most part, banks are also complying with the setting and circumstances section of the Interagency Statement (i.e., conducting sales or recommendations of nondeposit investment products in an area segregated from the area where retail deposits are taken.) Again, where examiners pointed out deficiencies to bankers, the bankers promised to take appropriate corrective action. During this year, many of the examinations focused on ensuring that actions taken since the previous examination were

effective.

Further, the 1996 year-to-date number of consumer complaints filed with the OCC shows a dramatic decrease from the number of complaints filed in 1995. Few noncompliance items have led to enforcement actions.

Consumer Brochure. To provide information directly to consumers, we published a brochure in December 1993 entitled Deposits and Investments: There's a Critical Difference. The brochure alerted bank customers to the risks in nondeposit products sold by banks. We have made nearly one million copies of the brochure available to the public, and it is also accessible on the OCC's World Wide Web site.

Disclosure Review Project. In 1994, the OCC gave national banks the opportunity to submit their disclosure materials to us for review. Our purpose was to give national banks an occasion to have their written disclosures evaluated at one time, and to ensure consistency in the guidance provided by the OCC in this rapidly developing area. More than 700 national banks voluntarily submitted more than 8,500 different documents for this review. We provided each participating bank a detailed analysis of the documents it submitted. We also provided national banks with a summary of the results of the review and the recommendations we made for corrective action.

"Best Practices" Review. Also in 1994, we concluded a "best practices" review of five banks that had undertaken significant efforts to inform their customers about the risks and returns of mutual funds. OCC staff assisted in designing questionnaires and monitored telephone conversations by bank employees with bank mutual fund customers. We performed this review to determine whether purchasers understood the risks associated with their purchase, especially the noninsured status of their investment. In particular, the OCC wanted to learn whether certain kinds of communication were more effective than others in helping customers understand the risks associated with mutual fund purchases. In this review, we found that the most important disclosure mechanism was the oral disclosure by the fund salesperson.

Coordination with the SEC. The OCC and the SEC share regulatory and supervisory interests regarding mutual funds. In 1995, the OCC and SEC agreed to coordinate endeavors related to oversight of investment advisory activities. For example, we and the SEC have conducted several joint examinations of banks and operating subsidiaries involved in investment advisory activities, and we will continue to coordinate joint examinations in the future. Also, we share a variety of supervisory and examination information with the SEC. In turn, the SEC gives us access to its inspection reports and examination information.

NASD Agreement. Eighty-seven percent of banks offering retail securities
brokerage services do so through registered brokerage subsidiaries or through arrangements with non-affiliated registered securities broker/dealers.(7)

____

7. See Banks' Securities Activities: Oversight Differs Depending on Activity and Regulator, GAO, 1995.

Hence, the banking agencies and the NASD share a common interest in the supervision of broker/dealers selling nondeposit investment products on depository institution premises and, in particular, the supervision of broker/dealers affiliated with a banking organization or thrift association. To promote regulatory consistency and reduce unnecessary burdens, the four federal financial institutions regulators and the NASD
signed an agreement in January 1995 to share information from examinations
that would be of interest to each other. The agreement also states that
the OCC and the NASD may request that an examiner be present during the other's examination of a banking organization. The OCC will refer apparent violations of securities laws to the NASD, and the NASD will refer apparent violations of banking laws to the OCC. Our District offices continue to work with the NASD according to the terms of this agreement.

You asked me to address how bank and nonbank securities personnel compare
in their sales practices of nondeposit investment products. We do not supervise nonbank broker/dealer sales representatives. Nevertheless, nonbank broker/dealer sales representatives who are members of the NASD are governed by the Rules of Fair Practice of the NASD. These individuals
in addition to having to adhere to the Rules of Fair Practice must also follow the applicable Interagency Statement guidelines if they are involved with a bank's sales program. Sales representatives who are solely bank employees must follow the Interagency Statement guidelines. The NASD's Rules of Fair Practice do not expressly apply to sales or recommendations made directly by the bank. The OCC believes that even when these rules do not expressly apply, they are an appropriate reference
for a bank compliance program to be designed to ensure that the bank's retail sales of all nondeposit investment products are operated in a safe
and sound manner. Further, the guidance of the Interagency Statement and
the Comptroller's Handbook for Retail Sales of Nondeposit Investment Products were developed along the lines of the NASD's Rules of Fair Practice. Finally, both bank and nonbank nondeposit sales representatives
are bound by the anti-fraud provisions of the federal securities laws.

NASD Qualifying Tests. Recently, the staffs of the three banking agencies
have been working with the NASD, the SEC, the Municipal Securities

Rulemaking Board, and the New York Stock Exchange to reach agreement on applying professional qualification and testing requirements similar to those for registered broker/dealers to bank employees who recommend or sell most securities. The three federal banking agencies are working on a proposed regulation that would require persons recommending or selling mutual funds and variable annuities at banks to pass the Series 6 examination, and persons recommending or selling mutual funds, variable annuities, and all other securities to pass the Series 7 examination. The proposed regulation excludes those who sell government and municipal securities at banks from coverage, because tests and/or regulatory requirements are imposed already upon persons involved in the sale of such securities. We anticipate publishing the proposed regulation in the third quarter of 1996.

The OCC has made great strides in improving disclosure, reducing regulatory burden, and making banks aware of the risks associated with mutual fund sales activities. Nevertheless, the problems we face go beyond disclosure, as I will discuss below. Given the increasing volume of assets invested in mutual funds, the OCC wants to learn more about mutual fund customers to anticipate and address future problems.

OCC/SEC Joint Survey

To increase our level of understanding, I asked our economists to work with the SEC on a joint study to investigate mutual fund investors' characteristics and level of knowledge about the risks of mutual fund investments. In 1994, the OCC and SEC contracted with Market Facts, Inc., an Illinois-based market research firm, to conduct a nationwide telephone survey of a randomly selected sample of mutual fund investors in the United States. Between June 28 and August 4, 1995, Market Facts conducted 2,000 telephone interviews of principal financial decision-makers who were eighteen years or older in households that own mutual funds.

The purpose of the survey was to gain a better understanding of the demographic, financial, and fund ownership characteristics of mutual fund investors, and discover how these characteristics vary by sales channel. Also, the economists designed the survey to provide data on mutual fund investors' familiarity with the costs and investment risks associated with mutual funds, and the information sources investors use to learn about costs and investment risks. Finally, the OCC and SEC economists went beyond questions solely related to mutual funds and attempted to assess the broader financial literacy among investors. I will summarize the key findings.

Demographic/Financial Characteristics. Overall, the survey found that the typical mutual fund investor has a profile somewhat different from the average U.S. citizen. The average investor is typically an older male who has attained a higher level of education and earns a higher level of annual income than the median U.S. household income. In examining differences between bank and nonbank mutual fund purchasers, we found that banks were more likely than nonbanks to sell mutual funds to women and to individuals sixty-five and older. Investors who attended graduate school were less likely to purchase their mutual funds from commercial banks, while investors who completed fewer than four years of high school were more likely to purchase mutual funds from a commercial bank. Commercial bank mutual fund purchasers on average also earned less than purchasers using other sales channels. These differences in characteristics strongly suggest that banks serve a different segment of the market from other mutual fund sellers. Table 3 summarizes these results.

TABLE 3:
Demographic Characteristics: Mutual Fund Investors

	Source of Mutual Fund Purchase			U.S.
	Bank	Nonbank	Total	
Median Age	45*	43	43	38**
% 65 or older	16.0%*	8.1%	9.3%	16.3%***
Median Income	$55,200	$59,400	$58,800	$38,782****
Attended graduate School	21.1%*	27.5%	26.5%	N.A.
Completed college and/or attended graduate school	49.3%	55.5%	54.5%	20.7%***
Attended some high school	3.7%*	1.5%	1.9%	10.9%***
Male	50.0%*	60.1%	58.6%	47.8%***

* Denotes statistical significance at the 5 percent level for bank/nonbank comparisons.

** Median age of the 1994 U.S. voting age population. Calculated from The Statistical Abstract of the U.S., 1995, p. 289.

*** Percent of the 1994 U.S. voting-age population. Source: The Statistical Abstract of the U.S., 1995, p. 289.

**** 1994 median U.S. household income. Source: U.S. Census Bureau.

Knowledge of Mutual Fund Investors. The survey asked respondents questions to determine their familiarity with the terminology, performance over time, expenses, and investment risks associated with mutual funds, and the information sources used to learn about these items. The results showed the vast majority of mutual fund investors (94 percent) knew they

could lose money in a stock fund. A substantial majority also knew they could lose money in a bond fund (72 percent) or a money market fund (64 percent). The latter statistic may be less troubling than it might seem at first blush. More than 25 percent of the respondents who believed an investor cannot lose money in a money market fund believed so because the fund holds "safe assets." Because the SEC limits holdings of money market funds to relatively short-term safe instruments, this survey response has some basis in fact.

The survey found virtually no difference in knowledge level between investors who purchased mutual funds from banks and those who purchased from nonbanks, despite the fact that the survey also found that bank investors were generally older and less well educated than those who purchased mutual funds from other distribution channels. Table 4 summarizes these results.

TABLE 4:
Investor Knowledge of Risk Associated with Mutual Funds

Type of Fund	Response	Source of Mutual Fund Purchase		
		Bank	Nonbank	Total
Equity Fund	Can lose money	93.9%	94.0%	94.0%
	Can't lose money	2.7%	1.8%	2.0%
	Don't Know	3.4%	4.2%	4.1%
Bond Fund	Can lose money	72.8%	71.6%	71.8%
	Can't lose money	13.3%	12.1%	12.3%
	Don't Know	14.0%	16.4%	16.0%
Money Market Fund	Can lose money	64.0%	63.8%	63.9%
	Can't lose money	20.1%	20.6%	20.5%
	Don't Know	16.0%	15.6%	15.7%

In general, the survey results indicated that the level of investor knowledge about expense ratios, loads, and fees could be improved. As Table 5 shows, only 19 percent of respondents gave an estimate of the expenses for their largest mutual fund, but 43 percent of those who were unable to provide an estimate replied that they knew a fund's expenses at the time of purchase. In addition, 70 percent were familiar with the term "sales load." Survey respondents appeared to be less aware of the negative relationship that typically occurs between fund expenses and fund returns. Only 16 percent of the survey respondents believed that higher expenses led to lower than average fund returns.

TABLE 5:
Investor Familiarity with Mutual Fund Costs

Source of Mutual Fund Purchase

	Bank	Nonbank	Total
Provided estimate of fund expenses	15.3%	19.5%	18.9%
Knew expenses at time of purchase	46.1%	42.4%	43.0%
Familiar with Sales Loads	62.6%*	70.7%	69.5%
Expect lower than average return from a fund with higher than average expenses	9.7%*	16.8%	15.7%

* Denotes statistical significance at the 5 percent level for bank/nonbank comparisons.

Generally, as Table 6 shows, the respondents named the prospectus, employer-provided materials, and financial periodicals as important sources of information. Nearly 60 percent of all respondents named the prospectus as a source of information, and 15.2 percent named it as the best source of information. Bank mutual fund purchasers were significantly less likely than nonbank fund purchasers to use a prospectus, and more likely to use a banker as a source of information. They most frequently cited friends or family as the most important source of information.

TABLE 6:
Frequently Cited Information Sources Used in Purchasing Funds

Information Sources	Source Used Source of Mutual Fund Purchas			Best Source Used Source of Mutual Fund Purchase		
	Bank	Nonbank	Total	Bank	Nonbank	Total
Prospectus	51.2%*	58.8%	57.7%	13.9%	15.4%	15.2%
Broker	27.4%	31.6%	31.0%	11.0%*	17.9%	16.9%
Friends/Family	40.4%	37.2%	37.6%	20.9%*	15.5%	16.3%
Financial newspapers or magazines	41.4%	42.1%	42.0%	13.6%	17.7%	17.1%
Employer	34.4%*	46.3%	44.5%	18.7%*	28.1%	26.7%
Banker	41.1%*	5.0%	10.3%	19.4%*	1.6%	4.2%

* Denotes statistical significance at the 5 percent level for bank/nonbank comparisons.

The authors of this report also went beyond questions related solely to mutual fund investments and attempted to assess the level of broader financial literacy among investors. They derived a measure of broader financial literacy by calculating a quiz score based on investors' correct answers to a number of questions. The results of this proxy for broader investor financial literacy suggest that investors can improve their overall financial knowledge. Other recent studies have confirmed this

finding. Money magazine and the Vanguard Funds Group conducted a survey of nearly 1,500 mutual fund investors and arrived at similar conclusions.(8)

Quiz respondents on average answered slightly more than half of the quiz questions correctly. On average, the scores generally improved with increased age, education, and income levels. Furthermore, respondents who reported that financial publications and the prospectus were the best sources of information scored higher on the test. Commercial bank mutual fund purchasers had statistically significantly lower mean quiz scores than nonbank fund purchasers. This is consistent with the demographics of commercial bank mutual fund purchasers, especially the likelihood of less education and lower income than nonbank purchasers.

To summarize, the survey results suggest that mutual fund investor knowledge of the expenses and risks associated with mutual funds could be improved, more so in some areas than others. This conclusion seems to hold regardless of the sales channel through which investors purchase the mutual funds. In most cases, bank mutual fund purchasers had the same level of knowledge about risks and expenses of mutual funds as nonbank fund purchasers, despite the fact that bank mutual fund customers were typically less educated and had less income than individuals who purchased their funds through alternative channels.

____

8. Also, see Survey: Financial Illiteracy, Bad Habits Dangerous Mix for Investors, Investor Protection Trust, May 1996.

Conclusion

Mutual funds continue to play a greater role in the investment portfolios of American savers. The OCC responded to this growth over the past few years by developing appropriate protections for consumers and safeguards aimed at maintaining bank safety and soundness and improving customer awareness of the risks associated with mutual funds. The results of the OCC and SEC economists' survey suggest that there is room for improvement in investor knowledge of the risks and expenses associated with mutual funds, and that more can be done to make mutual fund prospectuses of greater use to investors. As the mutual fund share of investor portfolios continues to expand in the future, the need to improve overall financial literacy will become more important as a greater number of less

financially sophisticated investors begin to purchase mutual funds.

The ongoing challenge of improving investor financial literacy extends well beyond simply designing regulatory requirements. Ultimately, the goal of better educated investors can only be achieved by a concerted joint effort involving numerous parties, including plan sponsors, brokers, fund companies, and governmental regulatory agencies. The growing importance of mutual funds and other nondeposit investments as savings repositories suggests that the federal government should be involved in this endeavor.

One possible avenue to improve investor understanding is to make the prospectus easier to read. Although the investors surveyed in our study consulted the prospectus more than any source of information, more than 40% of those surveyed purchased their funds without reading the prospectus. Moreover, the survey respondents considered the prospectus only the fifth best source of information about the funds they purchased.
We are aware that the SEC is exploring ways to shorten and simplify the prospectus, and we support that effort.

We welcome opportunities to work with other agencies in this regard.