Testimony
of
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Mr. Chairman and Members of the Committee, I am John Gannon, Senior Vice President for Investor Education with the Financial Industry Regulatory Authority, or FINRA. On behalf of FINRA, I'd like to thank you for the opportunity to testify today. FINRA and the FINRA Investor Education Foundation are committed to expanding the knowledge and confidence of all Americans wishing to build a more secure financial future through saving and investing, and we share your interest in protecting those savings and investments.

FINRA and the FINRA Investor Education Foundation

FINRA is the largest non-governmental regulator for all securities firms doing business in the United States. FINRA was created in 2007 through the consolidation of NASD and the Member Regulation, Enforcement and Arbitration divisions of the New York Stock Exchange. FINRA touches virtually every aspect of the securities business—from registering and educating all industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities, and administering the largest dispute resolution forum for investors and registered firms. All told, FINRA oversees 5,000 brokerage firms, about 172,000 branch offices and more than 676,000 registered securities representatives.

FINRA believes investor protection begins with education. Using the Internet, the media and public forums, we help investors build their financial knowledge and provide them with essential tools to better understand the markets and basic principles of saving and investing. We issue educational materials to alert investors to potential problems and provide "plain English" explanations of products and processes. We have developed a variety of interactive tools for investors to use in making financial decisions. We conduct public education events to reach out to investors.

In addition to the investor education activities of FINRA itself, the FINRA Investor Education Foundation (FINRA Foundation) is the largest foundation in the United States dedicated to investor education. Its mission is to provide underserved Americans with the knowledge, skills and tools necessary for financial success throughout life. To further this mission, the Foundation awards grants to fund educational programs and research aimed at segments of the public who could benefit from additional resources. Since the FINRA Foundation's inception in December 2003, it has approved more than $31 million in financial education and investor protection initiatives through a combination of grants and targeted projects. Many of those projects target underserved segments of the population, including a particular focus on senior investors and military personnel and their families so that they are able to avoid fraudulent and inappropriate products and sales pitches and manage their money with confidence.

Current Financial Environment

A recent study by AARP found that in 2007 more than 1 in 5 debtors were over the age of 55, compared with 1 in 10 back in 1991. The study also found that the rate of personal bankruptcy filings among those ages 45 to 54 had jumped by more than 48 percent from 1991 to 2007. For those ages 55 to 64, the rate rose by 150 percent—and for those ages 75 to 84, by 433 percent. These are very disturbing numbers by any measure. But they represent the hard realities of today's financial environment for many Americans, especially when combined with the rising costs of food and fuel, declines and volatility in the housing and financial markets. And they represent a challenge for policy makers and regulators.

In tough financial times, many people feel pinched for cash—and some may search for different, often risky ways to make ends meet, or to maintain a certain lifestyle. Troubling trends include trading in insurance policies in transactions known as "life settlements," tapping the home equity through reverse mortgages, and today's topic –leveraging or prematurely depleting retirement savings.

At FINRA, we are concerned that some investors may be risking one of their most valuable assets in an effort to raise cash—including those in or near retirement, who may not have time to recover their losses. And unfortunately, some unscrupulous financial professionals—many of them unregistered—feed into this investor anxiety, pushing strategies and products that promise to provide balance and safety, but that often end up haunting an investor for a lifetime.

Early Withdrawals of Retirement Savings

There is no doubt that Americans are increasingly making early withdrawals of their retirement savings. Fidelity Investments reported a 17 percent increase in 401(k) hardship withdrawals last year, and T. Rowe Price reported a 10 percent increase. The number of 401(k) loans is also on the rise. In 2006, 11 percent of investors took loans from their plan. In 2007, the number of loans jumped to 18 percent.

These numbers serve as a warning sign, demanding extra vigilance on the part of regulators. FINRA is paying particularly close attention to products and strategies that allow investors to easily tap their retirement savings prematurely. We are concerned that some financial advisers have started advocating the use of retirement accounts as a way to address their clients' current cash problems or to recommend unsuitable investments or strategies for those funds while promising unrealistic returns.

But from FINRA's perspective, protecting investors today is made more complicated because there are many products that may be suitable for some investors, but are very unsuitable for others. If it were simply a matter of banning certain products, our job would be very easy. But we know that even products like variable annuities, which create issues when sold to the wrong people, can have legitimate value for some investors. At FINRA, we've taken a two-pronged approach to help protect investors in these unsteady times.

First, we use our surveillance and enforcement tools to detect and deter abusive sales practices, especially those aimed at seniors. Second, we do everything we can to educate investors to help them make the best financial decisions for their unique situation.

I'd like to highlight two areas of concern for you today. The first involves early retirement account withdrawals. The second is the relatively new phenomenon of 401(k) debit cards. Both are troublesome because they may make it easy—too easy—for investors to unlock retirement savings before they really need it.

Early Retirement Seminar Scams

Section 72(t) of the IRS code permits penalty-free early withdrawals from company-sponsored plans before the age of 59 ½. What we are seeing is that some financial advisers tout Section 72(t) as a "loophole" that allows investors to retire early by withdrawing assets through a series of substantially equal periodic payments and reinvesting in products that offer higher rates of return.

In some cases, the financial advisers may promise that the investments will generate returns high enough to allow the investor to maintain a standard of living that is equal to or even higher than they have while working. However, the promised rate of return is often unrealistically high, and investors are often not told about the potential downside to these investments, including the potential for total depletion of their retirement savings. Many times victims entrust a broker with the entire cash proceeds of their retirement accounts—forfeiting their right to receive a lifetime monthly benefit under their company's pension plan.

In recent cases, FINRA fined two securities firms (Citigroup and Securities America) $5.5 million and ordered them to pay $26 million in restitution related to this type of early retirement investment scheme. Given the aging U.S. demographic, this is a problem that is likely to grow and we are watching firms very closely to make sure investors are treated properly.

401(k) Debit Cards

In addition, there is a relatively new way investors are accessing funds from their retirement plans—the 401(k) debit card, which is like a debit and credit card rolled into one. It acts like a debit card because it allows investors to access and spend their own money, rather than someone else's. But it also acts like a credit card because investors need to repay their balances over time.

FINRA published an Investor Alert outlining the pros and cons of 401(k) debit cards in May—and we hope investors heed our warnings. The pitfalls of theses debit cards are many.

Investors use a 401(k) debit card to borrow directly from their 401(k) account. Consumers can use the funds for any purpose and usually don't have to explain why they need the money or how they intend to spend it. But as they spend it, the potential is very high that they may wipe out a good portion of their retirement savings in the process. There can be significant tax liabilities, lost opportunity costs and even exposure to creditors of funds borrowed from retirement accounts if the investor ultimately has to declare bankruptcy.

If that weren't enough of a deterrent, the cards also charge interest and fees. The interest rate is usually tied to the prime rate, but a portion of that interest, as well as any fees, are paid to the card vendor. In addition to these finance charges, there may be set-up fees, annual fees and cash advance fees—so individuals should think long and hard before they sign up.

Taking money out of your retirement savings, even for a short period of time, can have enormous repercussions for your retirement security. The results can be disastrous if you never put that money back.

FINRA Investor Education Initiatives and Tools

As mentioned above, at FINRA, we believe the first line of defense in protecting investors is education. In support of that belief, FINRA and the FINRA Investor Education Foundation have developed a variety of tools and resources to educate investors about the importance of retirement savings and the potential impacts of early withdrawals, to encourage retirement savings and to assist investors in avoiding scams. Several of those efforts are outlined below:

- **401(k) Learning Center**
  To help investors of all ages with retirement savings, FINRA has developed an online 401(k) Learning Center, which is available on our Web site at *www.finra.org/investorinformation*. The center walks visitors through everything from the enrollment process, to the role of risk and reward when making allocation decisions, to issues of portability and the risks posed by cashing out of a 401(k) plan before retirement.

- **Investor Alerts**
  In addition, we regularly publish Investor Alerts to highlight issues, trends, pitches and products where we see danger of jeopardizing the secure financial future of U.S. investors. Several of our recent alerts have dealt specifically with retirement savings issues, notably *401(k) Debit Cards – Think Before You Swipe; Look Before You Leave: Don't Be Misled By Early Retirement Investment Pitches That Promise Too Much; Weathering Tough Financial Times—The Long-term Costs of Quick Cash, Think Twice Before Cashing Out Your 401(k), and Putting Too Much Stock in Your Company—A 401(k) Problem.*

- **Resources to Guard Against Early Retirement Seminar Scams**
  To assist employers and employees in guarding against early retirement seminar scams, FINRA introduced two online resources earlier this year. The resource for companies, *Help Your Employees Achieve Their Retirement Dream: Tips for Spotting Early Retirement Scams*, offers tips on how to evaluate the financial professionals involved in early retirement seminars and the seminar materials such as invitations, slides, handouts and scripts. Company representatives may also refer early retirement seminar materials

to FINRA for review if they have concerns. FINRA staff will review all seminar materials referred and inform the company whether the materials are consistent with applicable FINRA standards. A second resource, *Early Retirement Seminars 101: Smart Tips for Spotting Retirement Scams*, alerts employees to the pitfalls of early retirement schemes. FINRA has worked with both the Society of Human resources Management and the International Foundation of Employee Benefit Plans to ensure broad dissemination of these resources.

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

- **Investor Protection Campaign for Older Americans**
  FINRA Investor Education Foundation-funded research unveiled in July 2006 shattered the stereotypes of senior investment fraud victims. The study revealed a fraud victim profile that was counterintuitive in many respects, as well as influence tactics used by fraudsters that were sophisticated and highly effective. These findings forced regulators and senior advocates alike to rethink how best to approach the challenge of equipping older investors with the tools and information they need to thwart fraudsters touting investment scams.

  In response, the FINRA Investor Education Foundation mounted a research-based, social change campaign designed to reduce the incidence of investment fraud among investors ages 55 and over. Earlier this year, the Foundation launched a pilot campaign to test social norm messages and intervention strategies that positively influence the behavior of older investors to decrease the likelihood that they will become victims of investment fraud. The pilot campaign was developed by the FINRA Investor Education Foundation, in collaboration with AARP, Washington State Department of Financial Institutions, Florida Office of Financial Regulation and noted experts in the fields of fraud and persuasion.

  The FINRA Investor Education Foundation's investor protection campaign seeks protect older investors from investment fraud by helping them to:

  Recognize that they are vulnerable to financial fraud;

  Identify persuasion techniques; and

  Reduce risky behaviors by asking questions and checking information.

  More information on the campaign, as well as additional financial education materials specifically aimed at the senior investor, are available on a website created by the FINRA Foundation: *www.SaveAndInvest.org/55plus.*

Conclusion
The need for retirement savings is greater than ever before, but people are tapping into that money with unprecedented frequency. We at FINRA are doing what we can to add to the chorus of voices trying to improve and increase retirement savings and combat the trend of using those savings before retirement except as a strategy of last resort. Through the means described above, we try to ensure that before investors withdraw funds from their retirement savings, they know the many good reasons to keep those savings intact. As we pointed out in a recent Investor Alert, people should at least consider the following before prematurely tapping into their retirement savings:

- **Tax Liability—**Unless you're over the age of 59 ½, you will not only have to pay income taxes on the amount you withdraw, but you will also be subject to a 10% tax penalty. In most cases, your employer will withhold 20% in federal taxes, so the amount you receive will be significantly lower than the amount you requested.

- **Opportunity Costs—**The repercussions of withdrawing funds from your 401(k) could be enormous in terms of lost growth opportunity. For example, let's assume you are 30 years old, and have a 401(k) balance of $20,000. If you leave that money alone, and your account averages a 6% rate of return over the next 32 years, your balance at retirement will be $129,068 when you're 62—even if you do not make any additional contributions during that time. If you take it out, you'll have nothing. Even if you have a shorter time horizon, you will forgo significant savings opportunities by taking money out of your 401(k). For a 45-year-old, that $20,000 will grow to $53,855 in 17 years.

- **Opening Assets to Creditors**—Under the Bankruptcy Abuse Protection and Consumer Protection Act of 2005, your creditors cannot touch your 401(k) balance or similar retirement savings account—even if, as a last resort, you file for bankruptcy protection. Balances in traditional and Roth IRAs are also protected up to a limit of $1 million. But if you take money out of your retirement plan through a loan or a hardship or regular withdrawal, your creditors can go after that sum.

If investors really need access to their retirement funds early, they should be aware that borrowing from a 401(k) may be a better option than taking a withdrawal. Depending on a plan's terms, investors may be able to borrow at a lower rate from their accounts than they could from a bank or other lender, and they won't have to pay taxes on the proceeds of that loan as they would with a withdrawal. Investors should pay back the loan, however, before it is treated as a withdrawal.

Again, FINRA appreciates the opportunity to testify on these important issues today. I'd be happy to take any questions you may have.