

Statement of William D. Lutz, Ph.D., J.D.
Professor of English
Rutgers University

I would like to thank Chairman Richard Shelby for this opportunity to comment on the Security and Exchange Commission's proposed requirement that investors be provided with both cost and conflict of interest information before they invest in mutual fund shares and certain other investments.

I have served as a consultant in plain language to the Securities and Exchange Commission, and I have worked with a number of corporations and mutual fund companies to revise their documents into plain language. I have also written extensively on plain language and clear communication.

I believe the SEC's proposal is an important step in the right direction. As the SEC notes in its proposed rules, providing this information will help investors determine the full cost of an investment. Both point of sale and confirmation of sale disclosure will certainly go far in revealing to investors just what they're paying in fees for a particular investment. However, I think the proposal, as good as it is, doesn't go far enough, and what it does propose doesn't help investors as much as it could or should.

Right now investors face many problems in trying to figure out how much it will cost them to buy, hold, and sell shares in a mutual fund. First, they are overwhelmed with data, all kinds of data. Please note that I say "data" not "information." "Data" consists of all the numbers, facts, and statements that fill the prospectus and the statement of additional information (SAI). Not only is there a flood of data, but it's located in two places. So, assuming intrepid investors have carefully read the prospectus, and have even managed the Herculean task of reading the

statement of additional information, just what have the investors learned? Who knows, because both documents offer “data” not “information.”

Data is not information. Information is that which leads to understanding. In other words, data must be transformed into information. And who has the responsibility of performing that transformation? I would argue that the responsibility lies not with investors but with those who would sell investments such as mutual fund shares to investors. It is the responsibility of the seller to provide investors with information, not data.

Transforming data into information is the function of information design. Professionals in information design deal with designing everything from web sites to the instrument panels in civilian and military airplanes. They also design documents that communicate information. Indeed, in 1984 one entire issue of *Information Design Journal*, the international publication of professional information designers, was devoted to “The Design of Forms and Official Information.” The editors of the journal said that this issue focused on the one question that concerned all citizens: how can complex organizations communicate with the public. Information designers have been working for over 20 years on the problems of designing documents that communicate complex information clearly. It would seem prudent, therefore, to use the skills of information designers when confronted with the challenge the SEC faces in designing their proposed set of disclosure forms.

Document design uses a variety of tools – from plain language to the best type face – to create a document that gives readers the information they need, and gives it to them simply, quickly, clearly, efficiently. Information design transforms data into information that readers can

use. With information design, sellers can design disclosure documents that give investors not data but information.

To insure that the forms they create do indeed communicate clearly and effectively, document designers evaluate their designs not theoretically but practically. They see how well the forms work when people use them. The procedure they use is called usability testing, and it's a well established methodology that produces documents that meet the needs of those who use them. When joined with information design, usability testing produces documents that communicate, in every sense of that word. Data not only becomes information, it becomes information that people can use quickly, easily, and with a minimum of errors or misunderstanding.

Through usability testing, document designers discover what people want to know, and what they need to know in order to accomplish a specified task. Usability testing can help the SEC learn what information, if any, to leave out of the document because investors find it unnecessary, as well as learning what information investors want included. And I would like to stress that usability testing is a professional field, with proper procedures, standards, and protocols. (See, for example, Carol M. Barnum, *Usability Testing and Research*, Longman, 2002; Joseph Dumas and Janice Redish, *A Practical Guide to Usability Testing*, Ablex, 1993; Jeffrey Rubin, *Handbook of Usability Testing*, Wiley, 1994) Investors should not have to root about the endless pages of dense, jargon filled prose of the statement of additional information. Nor should they have to piece together the information they need from the data scattered throughout the prospectus.

I am sure that usability testing would quickly reveal a fundamental problem with the SEC's proposed disclosure forms: all the forms present disclosure from the point of view of the seller, not the buyer. The proposed forms are designed to insure that the broker conforms to the new rules about disclosure. They are not designed to communicate the information investors want and need to make informed decisions. Indeed, at this point no one, neither the SEC, I, nor anyone else, knows what investors want to know because as far as I know no one has asked them in a systematic, controlled way designed to elicit accurate, reliable information.

Right now investors have to assemble data from the prospectus and the statement of additional information. While the new forms proposed by the SEC will ideally present the most important cost data gathered from these two documents, we must remember that we are adding another document to the hierarchy of data for investors. These new forms should not replace the prospectus or the statement of additional information but should be designed to function as part of this hierarchy. The new forms should present in summary format the essential information about costs based on the statement of additional information and the prospectus, both of which should continue to be available to those investors who want to consult them. But the addition of these summary forms does not address the question of what information should be communicated to investors that it not now available.

To be sure, the SEC's call for comments on its proposed rules has elicited many comments, but these are from those people who just happened to learn about the proposed rules. These comments will certainly be helpful, but this procedure does not systematically engage investors in seeking to discover what they want to know. Document design and usability testing is a more effective, accurate, and reliable way to find out if these rules and the proposed

disclosure forms will provide the information that investors need, what information investors want, what kind of forms will best communicate that information, and the best way to present the information so investors can use it.

Generally speaking, I think investors want to know what I, as an investor, want to know:

1. what will it cost me to make this investment;
2. what will it cost me while I own it;
3. what will it cost me to sell it; and
4. are there alternatives that are better and cheaper for me?

These are the money issues, and it shouldn't be difficult to provide this information to investors. However, as *The Wall Street Journal* recently (March 17, 2004) pointed out, mutual fund investors may be paying significant transaction costs while they hold their shares, and they probably don't know they're paying them. These costs are difficult to locate because, in the words of the *Journal*, they're "buried." The SEC has discussed these hidden costs in its concept release number 33-4389 (December 19, 2003) "Request for Comments on Measures to Improve Disclosure of Mutual fund Transaction Costs." In this release, the SEC identifies the transaction costs of commissions, spread, market impact, and opportunity. While estimates of the magnitude of these costs vary, it is clear from the studies cited by the SEC that these transaction costs can add up to a significant expense, an expense which occurs yearly. These costs can substantially affect the rate of return for long term investors, as the *Journal* article dramatically illustrates in its hypothetical examples. Yet most of these costs are not revealed in any currently available documents for investors.

And this leads to another problem with the SEC's proposed disclosure forms. As presented, these forms imply that investors are being told of all the costs they're paying. Since the present proposal makes no provision for revealing these hidden costs in any disclosure form, investors are not informed of all the costs they're paying over the term of the investment. If these transaction costs are not included in the disclosure form, investors should be told that the expenses as listed on the form do not include transactions costs over the life of the investment, and these costs may significantly affect the return on their investment.

I am submitting with my statement a sample revision of the SEC's proposed disclosure form for a confirmation of a hypothetical purchase of a class A share (Attachment 1 to SEC Release No. 33-8358, January 29, 2004). This redesigned form is the result of a term effort that included me, Nancy Smith (who previously served as Director of the SEC Office of Investor Education and Assistance) and Dan Koh, of The Corporate Agenda, a design firm in New York. I must stress that this is not a final copy because we didn't have time to conduct usability testing to refine the form. We addressed what we saw as the design deficiencies in the proposed SEC form, and we've tried to produce a document where investors can see in one place all the information that is currently available. And we have tried to design a form that communicates quickly, clearly, efficiently using both plain language and good document design.

In our form we tried to include all the data we thought important for investors and we tried to turn it into information that the investor can use. Since we did not have the opportunity to conduct usability testing on the form, we don't know what information isn't included in our form that investors would want included, nor do we know if investors would find unnecessary any of the information we've included. We did try to make the information clear, simple, and

accessible. Among other techniques, we use serif type face, a readable type size, lots of white space, plain language and no jargon, and we defined in context any terms we thought needed to be defined. We simply eliminated the full page of definitions included with the proposed form because it's been our experience that no one will read these definitions, let alone understand any of them. If a technical term is necessary in the disclosure form then it should be defined in the context in which it is used, but we found we could avoid technical language and still be clear and accurate. In short, we followed many of the principles of information design and plain language, principles that are listed and explained in the SEC's own publication, *A Plain English Handbook: How to create clear SEC disclosure documents*, which the SEC published in 1998 under the aegis of Nancy Smith and which I helped write. (You can download a copy of the handbook at www.sec.gov/pdf/handbook.pdf.) I am including a copy of the handbook with my statement.

Let me repeat that I think the SEC's proposed disclosure rules are extremely important in improving disclosure to investors. But let me also repeat and emphasize that as proposed the disclosure forms simply aren't up to what should be the SEC's standards for clear and effective financial disclosure documents. I have suggested here what can and should be done to make these forms really disclose information in a way that investors can use. I have also included a sample to suggest ways in which the SEC can improve its proposed forms.

Finally, I would like to urge that given the importance of clear, effective communication in financial disclosure documents the SEC should incorporate document design and usability testing into its regular procedures for producing all such documents. Many federal agencies have already made extensive use of usability testing and document design to produce forms and

documents, among them the Food and Drug Administration, Federal Trade Commission, National Institutes of Health, Internal Revenue Service, Veterans Benefits Administration, Federal Aviation Administration, and the Department of Housing and Urban Development.

The SEC must do more than just give investors new and better information. It must give investors this information in a form and format that really communicates and doesn't simply present numbers. Document design is just as important as any other consideration when creating a financial disclosure document. I believe the SEC has done and continues to do an excellent job in providing American investors with access to more financial data than investors in just about any country in the world. Now the SEC needs to take the next step to ensure that this data is transformed into information that investors can use. We must always remember that disclosure isn't disclosure if it doesn't communicate.