
**UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION**

In the Matter of)
)
NATIONAL ASSOCIATION OF)
INVESTMENT PROFESSIONALS,)
Petitioner)
)
)
)

**REQUEST FOR REVIEW OF ONLINE BROKERAGE ADVERTISING
PRACTICES IN THE FINANCIAL SERVICES INDUSTRY**

December 13, 1999

Pursuant to 16 C.F.R. §§ 2.1 and 2.2 (1999) and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, *et seq.*, the National Association of Investment Professionals ("NAIP") hereby requests that the Federal Trade Commission (the "FTC" or "Commission") commence a review into the advertising practices of the brokerage industry--especially those advertisements that concern on-line investing. As described more fully below, the rapid growth of Internet-related commerce and marketing has given rise to increasingly aggressive advertising for online investment opportunities, and for the full service brokerage firms. Although online investing may offer significant advantages for some investors, the facts are in danger of disappearing behind the hype.

According to a recent *New York Times* article, the top ten online brokerages have budgeted

almost \$1.5 billion to fund their advertising campaigns for the coming year.^{1[1]} Many of these online pitches will be targeted to new and inexperienced "day traders" or other online investors who unwittingly risk significant losses in their zeal to "get rich quick". Advertisements aimed at these consumers frequently promise: (i) greater earnings from online trading than from using traditional brokers; (ii) unrealistic success rates from online trading; (iii) the ability to access markets directly on the Internet; (iv) the availability of more or better market research to guide investors; and (v) the availability of quicker or more accurate advice. In addition, these pitches often fail to disclose the significant risk of substantial financial losses, as well as the use of unexpected practices, such as higher charges for anything but market orders (customers are charged more for limit and stop orders). As Arthur Levitt, Chairman of the Securities and Exchange Commission ("SEC"), recently observed with respect to advertising for online brokerage services, "[q]uite frankly, some advertisements more closely resemble commercials for the lottery than anything else. When firms, again and again, tell investors that online investing can make them rich, it creates unrealistic expectations."^{2[2]} According to Levitt, "[e]liminating deceptive marketing and advertising practices is a big part of the solution."^{3[3]}

Absent careful scrutiny by the FTC, these online practices will continue to grow, fueling controversy and undermining the confidence of the investing public. It does not appear that self-regulation will address questionable advertising practices. NASD Regulation, Inc., the regulatory

^{1[1]}/ Joseph Kahn, Online Brokerages Use Advertising in a Battle For New Customers, The New York Times On The Web (Oct. 4, 1999) <<http://www.nytimes.com/library/tech/99/10/biztech/articles/04trad.html>>.

^{2[2]}/ Arthur Levitt, Plain Talk About On-line Investing, Address Before The National Press Club (May 4, 1999) <<http://www.sec.gov/news/speeches/spch274.htm>>.

^{3[3]}/ Oral statement of Arthur Levitt before the Senate Permanent Subcommittee on Investigations, Committee on Government Affairs, Concerning Day Trading.

arm of the National Association of Securities Dealers, Inc., has stated that it feels it is more the responsibility of brokerage firms to follow the NASD Regulation advertising rules, than it is for NASD Regulation to enforce them.^{4[4]} Unless the expertise of the Commission is brought to bear, this controversy will harm not only consumers, but all providers of investment services -- online or off.

Interest of Petitioner

Founded in 1996, NAIP is a not-for-profit membership association that brings together individuals and companies committed to helping investors achieve their financial goals. Its members are licensed, registered investment professionals who assist retail investors and who agree to follow the NAIP's Code of Ethics and Rules of Professional Conduct. The NAIP seeks to protect the interests of both its membership and the public. As described below, these investment professionals have borne the brunt of ads unfairly depicting their services as useless or inferior to the services of online brokers.

^{4[4]} See Elisse B. Walter, Remarks at NASAA Online Suitability Roundtable Discussion (Nov. 1, 1999). Ms. Walter is the Chief Operating Officer of NASD Regulation, Inc. Audiotape of the discussion is available from North American Securities Administrators Association, Inc.

Examples of Controversial Advertising Practices

It is important to note the context in which much online advertising occurs. Many commercials portray brokers in country clubs, mansions, or otherwise enjoying the benefits of their sales commission that impoverish their clients. Satire in advertising does not itself violate the law, but when combined with claims about the advertised services, the context can give significant meaning to claims of superiority. Needless to say, the same principles apply to advertising for full service brokers, if and when they claim their advice is the key to success. An objective claim that an investor will make more money is one that must be truthful and substantiated.

§ Certain advertisements represent that investors will obtain greater earnings from online trading than they would with traditional stock brokers. • Other advertisements promise unrealistic success rates from online trading using slogans like "make yourself rich" or showing enormous mansions or other extravagant possessions. • Many ads tout the ability to access markets directly on the Internet with phrases such as "immediate access" or "trade anytime." • Some ads promise the availability of quicker or more accurate investment advice by showing unresponsive stock brokers and by claiming better service and/or faster response. • Certain ads also claim that online brokerages provide better research than traditional stock brokers, provide more current information, or offer the ability to make you an "expert."

§ An emerging theme in these ads is that online investors are "empowered" by the ability to make their own investment decisions, free of brokers, because so much information is now available on the Internet. But as SEC Commissioner Laura Unger noted recently, the "flip side" to investor empowerment is that the excitement generated by online trading causes more frequent trading, which may result in disastrous losses.^{5[5]} Such active trading can cause investors to get in over their heads and may hurt their long-term investment results. • Many advertisements also fail to disclose material information regarding online trading. For example, ads may omit that trades are only made during traditional business hours or that limit and stop orders cost significantly more. • Some ads imply that investors will actually lose money if they invest with traditional stock brokers. • Several commercials tout a "get rich quick" message that is very similar to the messages used by many lotteries. • Some ads depict the traditional stock

^{5[5]}/ Laura S. Unger, Does The Internet Empower or Just Excite Investors?, Address Before The Harvard Club (Sept. 10, 1999) <<http://www.sec.gov/news/speeches/spch294.htm>>.

broker as the “enemy” of the investor. In this scenario, the viewer is told that the stockbroker is the excuse for any disappointing results, and if the investor removes the stock broker as the impediment, then success will be certain.

The Federal Trade Commission

The FTC is the agency charged with responsibility to regulate unfair and deceptive acts and practices under Section 5 of the FTC Act. Over the past several years, the agency has appropriately made marketing and advertising for products and services on the Internet a top priority. The FTC's active education and enforcement efforts have resulted in numerous guidelines, educational brochures, advisory bulletins, and enforcement actions to prevent unfair and deceptive practices on the Internet.^{6[6]} As Bureau of Consumer Protection Director Joan Z. Bernstein has frequently stated, when it comes to consumer protection, the rules in cyberspace are no different from the rules anywhere else.

In accordance with the Commission's Policy Statement on Deception, the FTC finds deception when there is "a misrepresentation, omission, or other practice, that misleads the consumer acting reasonably in the circumstances, to the consumer's detriment."^{7[7]} In evaluating whether a misrepresentation has been made, the Commission conducts a two-part analysis: (1) What express and implied claims have been made? and (2) Do they have a reasonable basis?

^{6[6]}/ The FTC has issued at least 20 consumer and business advisories and has offered comments and testimony on Internet advertising issues. In addition, it has held five different workshops on Internet-related commerce and marketing issues. It also has brought scores of enforcement actions.

^{7[7]}/ Policy Statement on Deception, 4 Trade Reg. Rep (CCH) ¶ 13,205 at 20,917 (FTC Oct. 14, 1983).

With respect to finding implied claims, the Commission considers the likely interpretation of the average consumer who is not technically expert, formulates understandings based on general impressions or cursory reading rather than careful examination, and is not inclined to be skeptical.^{8[8]} All of these characteristics typify the novice trader who is likely to be among the target audience for online brokerage pitches. This fact has been noted by SEC Chairman Arthur Levitt. Commenting on the significant differences between purchasers of securities and purchasers of most other consumer products, Levitt noted that "[b]rokers have always had duties to their customers that go beyond simply 'buyer beware';' he expressed concern about" the great influx of new and relatively inexperienced investors who may be so seduced by the ease and speed of the Internet trading that they may be trading in a way that does not match their specific goals and risk tolerance."^{9[9]}

^{8[8]}/ See *Standard Oil Co. v. FTC*, 577 F. 2d 653, 657-59, (9th Cir. 1978).

^{9[9]}/ Arthur Levitt, Plain Talk About On-line Investing, Address Before The National Press Club (May 4, 1999) <<http://www.sec.gov/news/speeches/spch274.htm>>.

The second part of the deception analysis is whether the express or implied claim has a reasonable basis.^{10[10]} The substantiation burden is especially high when, as is the case with many of the adventuresome claims at issue, the truth cannot be easily be determined by the average consumer.^{11[11]} Based on the available information, there appears to be little, if any, support for claims that suggest superior results from online investing. To the contrary, in research comparing the success of investors who switched from phone-based trading to online trading, two university professors recently found that after switching to online trading, investors generally traded more actively, more speculatively, and less profitably than before.^{12[12]} (A copy of the draft report of this study is attached hereto.) The authors concede that investors who do not increase their level of trading when they trade online *can* save money on a per trade basis. They emphasize, however, that investors who trade more actively online will tend to offset the per trade savings with higher total trading costs and with losses due to the more speculative trading, and that this was the case with most investors in their study.^{13[13]}

Support for other superiority claims, e.g., that electronic trades can be executed more reliably and successfully than brokered trades, that better research is available to online traders, and/or that there are few downside risks to online investing, is similarly suspect. The available information indicates that it is unlikely that support for such claims could meet consumers' expectations. For instance, the university research comparing the success of investors who

^{10[10]}/Statement on Advertising Substantiation, 49 Fed. Reg. 30,999 (FTC 1984).

^{11[11]}/See Policy Statement on Deception at 3.

^{12[12]}/See Brad M. Barber & Terrance Odean, Online Investors: Do The Slow Die First? (Draft Report, September 1999)

<http://www.gsm.ucdavis.edu/~odean/papers/Online/Online.html>.

^{13[13]}/*Id.*

switched from phone-based trading to online trading concluded that investors traded less profitably after they switched to online trading.^{14[14]} Whether or not there is adequate support for such claims is a question we urge the FTC to address. Unless and until the truth of these claims can be demonstrated, they should not be permitted.

^{14[14]}/See Brad M. Barber & Terrance Odean, *Online Investors: Do The Slow Die First?* (Draft Report, Sept. 1999)
<<http://www.gsm.ucdavis.edu/~odean/papers/Online/Online.html>>.

In addition to express and implied misrepresentations, the FTC's deception standard covers the omission of material information. Material information is information that affects the consumer's decision to purchase the advertised goods or services. When advertising claims are likely to create erroneous impressions or expectations about a product, advertisers have an obligation to disclose material facts to correct that misimpression. This obligation clearly applies to the duty to disclose, *inter alia*, the risks associated with trading when claims are made about the returns from trading. For example, while sales commissions may be lower for electronic trading, many additional factors determine investment success, including the value of research on the investment, the speed and accuracy of electronic communications used to execute the trades, the price at which the trade is made and the frequency of trading. All of these are factors that inexperienced investors may not appreciate. Accordingly, a claim that online investing yields greater profits because commissions are lower can be deceptive if it fails to reveal that other aspects of online investing may drive up costs. Careful scrutiny of the advertising claims and tactics used to promote investment services is squarely in line with the FTC's priority to make cyberspace a marketplace consumers can trust. This goal is shared by NAIP and serves to benefit reputable investment services everywhere.

On behalf of NAIP, I urge the Commission to focus careful attention on the practices in this industry and to provide the necessary guidance and enforcement efforts to maintain the confidence of consumers and competitors in this important, rapidly expanding market.

Respectfully submitted,

WILLIAM C. MacLEOD