

**MEMO# 23361**

March 31, 2009

## **Remarks by ICI President and SEC Investment Management Director at 2009 Mutual Funds and Investment Management Conference**

[23361]

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TO: COMPLIANCE MEMBERS No. 15-09  
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 13-09  
INVESTMENT COMPANY DIRECTORS No. 5-09  
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 13-09  
PRIMARY CONTACTS - MEMBER COMPLEX No. 5-09  
SEC RULES MEMBERS No. 36-09  
SMALL FUNDS MEMBERS No. 24-09 RE: REMARKS BY ICI PRESIDENT AND SEC INVESTMENT MANAGEMENT DIRECTOR AT THE 2009 MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE

Last week, Institute President and CEO Paul Schott Stevens delivered the opening address at the 2009 Mutual Funds and Investment Management Conference in Palm Desert, California. SEC Division of Investment Management Director Andrew J. Donohue was the keynote speaker. Their remarks are briefly summarized below. [\[1\]](#)

### **Remarks by Mr. Stevens**

Mr. Stevens began his address by highlighting the three major issues that the financial crisis has raised for mutual funds and other investment companies—the operation and regulation of money market funds, regulatory reform, and retirement security—and the vigorous policy agenda ICI, with the leadership of senior executives of our member complexes, has followed to address each of these areas.

First, with respect to money market funds, Mr. Stevens noted that ICI's Executive Committee formally chartered a Money Market Working Group last November to examine the market events of last fall and propose ways to make money market funds even

stronger. Led by Vanguard's Chairman Jack Brennan, the Working Group recently issued a report that literally 'wrote the book' on money market funds, providing "the blueprint for the future of this vitally important product." He described the Group's report noting that it offers new and heightened standards for the operation of money market funds in every key area, including liquidity, credit quality, maturity, client concentration, and transparency. He also described recommendations that would allow a fund to treat all investors in a fund fairly if that fund should break a dollar in a future financial crisis. Mr. Stevens then noted proposals made by others—barring funds from using a fixed \$1.00 net asset value, requiring insurance for money market funds, or converting these funds into special-purpose banks—that the Working Group concluded are impracticable and could hurt investors, issuers, and other participants in the money market. Finally, he noted that ICI's Board of Governors unanimously endorsed the report's recommendations and called upon all money market funds to follow suit by adopting those proposals and practices that can be implemented without regulatory action before September 18 (the last day that the Department of the Treasury has legal authority to operate the Temporary Guarantee Program, should it be extended).

Next, Mr. Stevens talked about ICI's recently published white paper on financial services regulatory reform that focused on the functioning of the capital markets and the regulation of investment companies. Specifically, he noted that ICI supports the creation of a 'Systemic Risk Regulator' to evaluate and identify risks that are "so significant that they implicate the health of the financial system." He stressed the need to carefully define the responsibilities of the Systemic Risk Regulator and its relationships with other regulators, noting that "[a]ddressing systemic risk effectively need not and should not mean stifling innovation, retarding competition, or compromising market efficiency."

Mr. Stevens then noted that ICI supports the creation of a new Capital Markets Regulator that would encompass the combined functions of the SEC and the CFTC and act as the standard setter for all registered investment companies, including money market funds. Its mission would not only focus on investor protection and law enforcement, but also have a mandate to consider whether its proposed regulations promote efficiency, competition, and capital formation. Mr. Stevens then suggested that there are several areas where the Capital Markets Regulator needs specific regulatory authority to close regulatory gaps, including hedge funds, derivatives, and municipal securities, particularly to improve disclosure. He also noted that the regulator needs explicit authority to harmonize the regulatory regimes for investment advisers and broker-dealers.

The balance of Mr. Stevens' remarks focused on retirement security. He noted that the bear market has had a significant impact on retirement savings and that critics have used the decline in account balances to argue that 401(k) plans should be eliminated. Mr. Stevens stated, however, that based on ICI research, working Americans strongly support 401(k)s. Nonetheless, he acknowledged that "401(k)s are at a crossroads and that they can and must be improved." In particular, he listed seven proposals that ICI believes Congress should consider, ranging from improved disclosure about fees, risks, and performance to fixing Social Security.

In closing, Mr. Stevens reminded the audience that funds are the "best vehicle for investors of average means to reach the financial markets and achieve their financial goals." He listed possible investment ideas of the next 20 or so years, noting that the fund industry will be there to help the average American share in the investment opportunities of tomorrow.

## Remarks by Mr. Donohue

Mr. Donohue began his address by acknowledging the various events that have created a mix of challenges for the fund industry in today's market. For example, he noted that funds and fund boards are facing increased operational pressures arising from a variety of factors, including a lack of liquidity in the marketplace and the resulting difficulties in valuation of many portfolio securities. He also stated that as a result of decreasing asset bases, funds may need to reconsider the time period and other aspects of the methodology normally used to compare fund expense ratios for 15(c) investment advisory contract reviews and determine comparable peer funds that have similar investment objectives and asset sizes. On the issue of money market funds, he specifically pointed to the challenges faced by the industry as a result of last year's "breaking of the buck" by a widely-held money market fund and the challenges posed by low or non-existent yields on treasury securities. Next, he discussed the increasing use by funds of derivatives and sophisticated financial instruments, noting that funds should "be attentive to counterparty exposure and ask the 'tougher questions' to evaluate potential credit and other risks," particularly with respect to these instruments.

Mr. Donohue then turned his attention to recent key initiatives in the Division of Investment Management. First, he acknowledged the Commission's adoption of the summary prospectus as one of the most significant accomplishments for mutual funds and their investors, commending, in particular, the productive collaboration among the Commission, the fund industry, and fund investors. Next, with respect to crisis management, he highlighted the staff's work relating to money market funds and auction rate preferred securities.

The balance of Mr. Donohue's remarks focused on the Division's future initiatives. He first noted his hope that the staff would be submitting its recommendations to the Commission concerning last year's proposal to provide guidance to fund directors with respect to soft dollars.

On the issue of Rule 12b-1, he noted that he believed that it would be "wise in the current market environment" for the Commission to defer consideration of Rule 12b-1 reform for this year, although he left open the possibility of providing guidance to fund directors to better assist them in this area. He stated instead that the Commission should address "fundamental matters that directly impact investor protection concerns," such as "reconcil[ing] the diverse regulatory regimes governing investment advisers and broker-dealers." He also noted his intent to move forward on providing guidance to fund directors in the valuation of portfolio securities, remarking that it has been "over 35 years since the Commission last provided significant and comprehensive guidance to funds and their directors concerning their valuation responsibilities ... ." As a step in this process, Mr. Donohue noted that the Division has posted on the SEC website a bibliography that lists select relevant provisions of the Investment Company Act of 1940 and related rules, proposing releases, select staff guidance, and enforcement actions concerning valuation. In addition to the specific areas of Rule 12b-1 reform and valuation guidance noted above, Mr. Donohue commented on the staff's continued focus on the general needs of fund directors. Based on director feedback and the Division's own analysis, he stated that the staff is preparing recommendations for the Commission's consideration that will suggest possible rule modifications and other guidance that may enable directors to focus more of their time on overseeing conflicts of interest rather than engaging in day-to-day management of the fund.

Mr. Donohue also stated that the Division will be considering reform of fund shareholder annual and semi-annual reports, acknowledging the impetus for the reform is the need for “mutual fund disclosure that is easier to understand and accessible to investors, while maintaining the same amount of disclosure that is available today.” Finally, in light of recent events, Mr. Donohue stated that he expected to quickly develop recommendations for changes to Rule 2a-7 to protect money market investors. To this end, he commended the ICI and the ICI’s Money Market Working Group and stated that the Group’s recommendations are a “good first step” in developing changes to Rule 2a-7.

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#### **endnotes**

[1] Mr. Stevens’s address, Meeting the Challenges of Financial Crisis, is available on the Institute's public website at [http://www.ici.org/pressroom/speeches/09\\_mfimc\\_stevens\\_spch](http://www.ici.org/pressroom/speeches/09_mfimc_stevens_spch). Mr. Donohue’s address is available on the SEC’s website at <http://sec.gov/news/speech/2009/spch032309ajd.htm>.

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