

MEMO# 18054

September 30, 2004

INSTITUTE PRESIDENT ADDRESSES CONFERENCE OF WESTERN ATTORNEYS GENERAL

[18054] September 30, 2004 TO: BOARD OF GOVERNORS No. 61-04 CEOS INVESTMENT COMPANY DIRECTORS No. 45-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 88-04 SEC RULES MEMBERS No. 143-04 SMALL FUNDS MEMBERS No. 107-04 PUBLIC COMMUNICATIONS COMMITTEE No. 23-04 RE: INSTITUTE PRESIDENT ADDRESSES CONFERENCE OF WESTERN ATTORNEYS GENERAL The Institute's President was recently invited to address a group of State Attorneys General at a Financial Issues Summit that was sponsored by the Conference of Western Attorneys General.* In light of the recent events, Paul Schott Stevens decided to focus his remarks on four areas: (1) the reaction of the mutual fund industry to the scandal; (2) the ways in which State and Federal law enforcement and other officials have responded to the scandal; (3) Congress's division of labor under the National Securities Market Improvements Act of 1996 (NSMIA); and (4) the importance of cooperation between the States and the Securities and Exchange Commission to advance and protect the interests of fund investors. Mr. Stevens's comments in each of these areas are briefly summarized below. Before discussing each of these areas, however, Mr. Stevens discussed the history of the Institute and its current mission; how the U.S. has become a nation of investors, and more particularly a nation of mutual fund investors; and how the attributes of mutual funds have resulted in their wide public acceptance over the past 25 years. THE FUND INDUSTRY'S RESPONSE TO THE SCANDAL After characterizing recent events as "the worst scandal to hit mutual funds in more than sixty years," Mr. Stevens noted that the industry has neither sought to downplay the issues nor to shift the blame for them. To the contrary, the industry has cooperated "as fully as possible" in a wide array of efforts to address the problems, including: calling for tough law enforcement; calling for full restitution to fund shareholders; urging the SEC to impose * See Remarks of Paul Schott Stevens, President, Investment Company Institute, Conference of Western Attorneys General, Financial Issues Summit (Sept. 30, 2004). A text copy of Mr. Stevens's address is available on the Institute's public website at http://www.ici.org/statements/remarks/04_cwag_stevens_spch.html. 2 mandatory redemption fees and new trading restrictions targeted at abusive market timing and late trading; and supporting the SEC's various regulatory reforms. Mr. Stevens recognized the industry's collective stake in the success of public and private efforts to both root out misconduct and preserve and bolster the confidence of investors and noted that "[w]e cannot afford to see a recurrence of conduct that abuses the trust of mutual fund investors." THE ACTIONS OF STATE AND FEDERAL OFFICIALS TO THE SCANDAL According to Mr. Stevens, the government's response to the scandal "should be highly reassuring" because State and Federal law enforcement officials acted promptly to identify and punish

misconduct, to deter it from happening again, and to hold investors harmless. He described it as “significant” that trading abuses were first identified by a State Attorney General and that senior State officials have taken steps pursuant to their enforcement authority to protect investors in their jurisdictions from fraudulent practices. While observing that “there is no perceptible gap in existing laws,” he noted that the SEC, “with an eye towards the needs of a national marketplace,” has crafted and is imposing a comprehensive set of additional regulations in response to the scandals. Also, however, market forces have responded to the scandal as demonstrated by the fact that companies named in investigations or enforcement actions have experienced a combined outflow of \$9.4 billion per month in their bond and stock funds from September through March of this year; while other companies not named in these actions have registered a combined in-flow of \$35.3 billion per month over this same period.

NSMIA’S ALLOCATION OF RESPONSIBILITY Mr. Stevens next discussed how, in his view, the recent scandal has demonstrated that NSMIA is working as intended. After discussing NSMIA’s division of labor – with the SEC assigned exclusive responsibility to regulate mutual funds and the States having authority to regulate and bring enforcement actions with respect to fraud and deceit – he noted that, consistent with NSMIA, the States have wielded their remedial, anti-fraud authority to good effect. At the same time, the SEC has exercised its prescriptive, regulatory authority to impose new, comprehensive nationwide standards on mutual funds to address the abuses identified in the scandal. According to Mr. Stevens, “the scandal has not been . . . the occasion for divergent and inconsistent regulatory responses by different States. Responses of this sort characterized State regulation of mutual funds prior to 1996 and ultimately led to the enactment of NSMIA.”

NECESSITY OF CLOSE COORDINATION BETWEEN THE STATES AND THE SEC With respect to the importance of Federal-State cooperation, Mr. Stevens stated that it is “absolutely essential” that the SEC and the States “cooperate closely, both in the law enforcement realm and on matters of regulatory policy.” While some State officials may suggest it desirable for States to modify or add to the body of Federal mutual fund regulation – for example, through States attempting to impose new disclosures on mutual funds – he asserted that NSMIA provides the most effective framework for advancing the interests of mutual fund investors. In particular, NSMIA’s framework should “be respected by operating to encourage a vigorous, continuing dialogue between the SEC and responsible State officials on issues” of concern to the States. He also noted that the SEC “has proved highly receptive to improvements in fund regulation, especially in the area of disclosure practices.” 3 * * * * In closing, Mr. Stevens emphasized the commitment of the Institute and its members to protecting the interests of fund investors in the States represented by the Conference and nationwide. He also expressed his interest in working with State regulators on this very important objective. Tamara K. Salmon Senior Associate Counsel