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PAUL SCHOTT STEVENS' FIRST ADDRESS AS INSTITUTE PRESIDENT

[17686] June 17, 2004 TO: BOARD OF GOVERNORS No. 45-04 CEOS CLOSED-END INVESTMENT COMPANY MEMBERS No. 43-04 INVESTMENT COMPANY DIRECTORS No. 30-04 PRIMARY CONTACTS - MEMBER COMPLEX No. 61-04 SEC RULES MEMBERS No. 91-04 SMALL FUNDS MEMBERS No. 70-04 UNIT INVESTMENT TRUST MEMBERS No. 27-04 RE: PAUL SCHOTT STEVENS' FIRST ADDRESS AS INSTITUTE PRESIDENT On June 15, at the National Press Club in Washington, D.C., Paul Schott Stevens delivered his first address since becoming President of the Institute. The address, entitled “America's Mutual Funds: The Road Ahead,” is briefly summarized below.1 Mr. Stevens began by observing that, in order to understand the challenges and obstacles ahead for mutual funds, it is first necessary to “understand the road we have traveled.” He offered some statistics to demonstrate the industry's phenomenal growth since 1978, the year in which he was first introduced to mutual funds. In his view, that growth is attributable not only to the strong market performance of the past 25 years but also to the fact that mutual fund investing is “a powerful proposition,” one that allows average investors an ideal way to meet their investment goals and accumulate wealth. Mr. Stevens asserted that there are four other factors that help explain why so many investors rely on mutual funds: accountability; the “mutual” character of mutual funds; accessible information that is thorough and reliable; and, most importantly, trust. In discussing accountability – that is, the legal and regulatory protections that protect fund shareholders – Mr. Stevens expressed the Institute's strong support for the Securities and Exchange Commission's extensive reexamination of mutual fund regulation since last September. He stated that the Institute would “bend every effort” to assist mutual funds in fully implementing new SEC regulations and realizing their full potential. With respect to mutuality, Mr. Stevens remarked that mutual funds “hold out the promise of a square deal and equal treatment,” because each investor receives a proportionate share of gains and pays a proportionate share of the expenses. 1 A text copy of Mr. Stevens' address is available on the Institute's public website at http://www.ici.org/new/04_npc_stevens_spch.html#TopOfPage. An archived webcast of the address may be viewed at http://www.connectlive.com/events/ici/. 2 As to accessible information, Mr. Stevens observed that the ability of mutual fund investors to “shop around” is a unique quality of American mutual funds not seen to the same degree with foreign investment funds or other financial products. He cautioned, however, that meaningfully informing investors, and not simply making disclosures, must be a constant objective for both the Institute and the SEC. Turning to the issue of trust, Mr. Stevens stated that investors are unlikely to risk their security in retirement or the education of their children unless they trust that their mutual funds are managed prudently and are committed to their interests. Investors, regulators, and the media are outraged at the recent abuses, he said, precisely because “we had come to expect better from mutual

funds, and because the abuses depart so radically from the duties we know mutual funds owe to their investors." He further observed that even though most fund companies were not involved in the scandals, "the scandalous conduct of one can and does risk the reputation of all." For that reason, said Mr. Stevens, the Institute and its members strongly support a comprehensive and forceful response by regulators. Mr. Stevens asserted that the lessons to be learned from the current scandals "have to do with what we must demand of ourselves – and what others have a right to insist on from us – when we accept the role of a fiduciary." He stated that the mutual fund industry must rededicate itself to first principles and to bolstering its fiduciary culture in responding to the scandals. He called it "the key challenge" for mutual funds on the road ahead. Mr. Stevens stressed, however, that the current scandals are not limited to mutual funds and that, in addition to comprehensive mutual fund reform, more is needed to prevent future abuses. With respect to intermediaries that sell fund shares, Mr. Stevens noted that they are typically obligated by contract to implement a fund's policies, but that recordkeeping conventions common across the industry prevent funds from having access to information about transactions by the ultimate owners of their shares and thus from enforcing their policies against abusive short-term trading. He reiterated the Institute's commitment to working with regulators and other interested parties to address this challenging issue. With respect to hedge funds, Mr. Stevens stated that investigations into the scandals have revealed that some hedge fund advisers engaged in "highly deliberate and predatory trading strategies . . . to pick the pockets of long-term mutual fund investors." He was critical of arguments that "even a modicum of regulation" would adversely affect the business model of unregistered hedge fund advisers. Said Mr. Stevens, "It would be ironic indeed to draw as a lesson from the recent scandals that myriad new regulations are necessary for mutual funds – but as for hedge fund advisers, it should be business as usual." He then endorsed the call by SEC Chairman Donaldson for at least some scheme of registration for hedge fund advisers. In closing, Mr. Stevens suggested that the road ahead for mutual funds will be demanding and will require renewed adherence to the four factors he outlined at the beginning of his address. He expressed his "absolute confidence" that America's mutual funds will be able to vindicate the confidence and trust placed in them by millions of investors, and he pledged his full commitment to help in this process. Rachel H. Graham Assistant Counsel

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