The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

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TRANSCRIPT OF RECENT MUTUAL FUND HEARING

August 12, 1993 TO: BOARD OF GOVERNORS NO. 72-93 RE: TRANSCRIPT OF RECENT MUTUAL FUND HEARING ____ As we recently informed you, SEC Chairman Levitt testified on August 5 before the Telecommunications and Finance Subcommittee of the House Energy and Commerce Committee on the state of the mutual fund industry. (See Memorandum to Board of Governors No. 71-93, dated August 10, 1993). Attached is a copy of the transcript of the hearing. Set forth below is a summary of the significant points addressed at the hearing. 1. SEC Resources - In his opening statement, Chairman Levitt stressed the need for additional resources for the SEC to regulate the mutual fund industry. He testified that while the assets under management have increased by over 430 percent since 1982, the SEC's investment company staff had increased only 74 percent. Levitt warned that the inspection program has been the "hardest hit" and that if additional examiners are not hired, the inspection program will not be able "to provide any real measure of deterrence or of investor protection." (See p. 14-15) 2. Sales Loads and Fund Expenses - In response to Chairman Markey's remark that sales loads and fund expenses are the "single greatest cause of confusion and frustration for most mutual fund investors", Chairman Levitt stated that clarity and uniformity in the disclosure of fees is important and that the fee table in the front of the prospectus has been a constructive step in this regard. (See pp. 19-22) With respect to the level of fees and expenses, Chairman Markey observed that mutual fund expense ratios have not decreased, even though assets in mutual funds have increased significantly. Chairman Levitt explained that part of the reason is due to the development of new services and products. (See pp. 22-24) In response to questions on 12b-1 fees, Chairman Levitt expressed skepticism about the collection of 12b-1 fees in certain circumstances, such as when a fund closes to new investors. He also expressed concern about the use of the term "no load" under the NASD rule for a fund that collects a 12b-1 fee of 25 basis points or less. Chairman Levitt stated that these issues require careful consideration and that he would work with the Subcommittee and the industry on them. (See pp. 50-53) 3. Section 22(d) - In expressing opposition to the recommendation in the SEC staff's study on investment company regulation to repeal Section 22(d) of the Investment Company Act, Chairman Levitt stated that "the removal of 22(d) might have unintended consequences." (See pp. 34-35) 4. SEC Review of Advertising - In response to an inquiry about the adequacy of the SEC's review of advertising materials of funds whose shares are not sold through NASD member firms and therefore file their advertising materials with the SEC, Chairman Levitt stated that the SEC is understaffed in this area and that it does not do as detailed an evaluation of these materials as the NASD does. When asked whether a SECO-like entity for overseeing those funds that are not sold through NASD broker-dealers should be established to address this problem, he responded that it is an issue that just recently came to his attention and one that the SEC will consider. (See pp. 33-34) 5. Marketing Practices - Chairman Levitt stated in response to a question about the use of fee waivers and funds guaranteeing investors a stated return for a specified period that he thought these practices were a form of "gimmickry" and that aggressive marketing techniques needed to be watched very carefully. However, he stated that he did not want to generalize about marketing techniques and noted that the American consumer is better informed than ever before in history. (See pp. 37-38.) 6. Summary Pospectus Proposal - Chairman Levitt strongly supported the SEC's proposal to allow investors to purchase mutual fund shares directly in response to a summary prospectus. (See pp. 57-64) Chairman Markey questioned how the NASD would be able to handle reviewing the new summary prospectus, since it now has only 13 people assigned to review advertising and sales material. Chairman Levitt responded that the NASD will clearly need additional resources to ensure that mutual fund advertisements are properly reviewed and that "the NASD must be encouraged to beef up their resources in that connection." (See p. 64) 7. Bank Sold Mutual Funds - In response to inquiries about the unique investor protection issues raised when mutual funds are distributed through banks, Chairman Levitt stressed the importance of ensuring that investors understand that funds are not federally insured like bank deposits. He also stated that there is a need for banks to "erect the kinds of firewalls to prevent abuses in terms of using their corporate business as an offset to what they are doing in the fund business," but that he was not prepared to make a specific proposal at that time. (See p. 55) In addition, Chairman Levitt was asked about the oversight of bank sales practices, especially in light of the New York City's Consumer Affairs report on mutual fund sales practices in which it was reported that only two out of five bank representatives contacted stated that the funds were not FDIC insured. He responded that bank funds that are not sold through registered broker-dealers are not subject to the NASD sales practice rules and that it is a very important area that should be addressed. (See pp. 55-56) 8. Unified Fee Fund - Chairman Levitt stated that while he believes that a unified fee structure would be desirable from the investor's point of view, it is very complex and he is not sure how to implement it at this time. (See page 41.) 9. Derivatives - Chairman Markey inquired about the propriety of mutual funds investing in derivative products, citing recent press articles that focused on the risks presented by these instruments. Chairman Levitt responded that mutual funds primarily use derivatives to hedge risks and that he does not believe that the extent to which mutual funds are using derivatives presents a danger. He cautioned against legislation to prohibit the use of derivatives, since "it would be taking away from the funds a legitimate device for protecting against unnecessary risk." (See pp. 65-68) 10. Disclosure in the Retirement Market - Chairman Markey and Chairman Levitt agreed that participants in employee-directed defined contribution plans need to receive all of the information necessary, in an understandable format, in order to make an informed investment decision. (See pp. 73-74) * * * We will keep you informed as developments occur. Matthew P. Fink President Attachment

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