

MEMO# 12938

December 18, 2000

SEC SPEECHES AT 2000 SECURITIES LAW DEVELOPMENTS CONFERENCE

[12938] December 18, 2000 TO: BOARD OF GOVERNORS No. 68-00 PRIMARY CONTACTS - MEMBER COMPLEX No. 80-00 RE: SEC SPEECHES AT 2000 SECURITIES LAW DEVELOPMENTS CONFERENCE Paul F. Roye, Director of the SEC's Division of Investment Management, delivered the keynote address at the Institute's 2000 Securities Law Developments Conference on December 4, 2000. SEC General Counsel David M. Becker spoke at the conference luncheon. Copies of their speeches are attached, and they are summarized below. Paul Roye's Remarks In his speech, Mr. Roye issued a series of challenges to the mutual fund industry to work with the SEC to maintain the highest standards "to preserve and bolster the trust that mutual fund investors have placed in the industry," and to strive for a culture in which "best practice becomes common practice." He also highlighted three areas that merit increased focus by fund management, compliance personnel and fund directors: valuation, best execution, and problematic portfolio management practices. Roye stated that valuation is extremely important for mutual funds and is an important area for board and management focus, "since proper valuation of fund portfolio securities is critical to ensure that the fund share prices derived from those valuations will be fair to purchasing, redeeming and existing shareholders." He specifically noted that fund directors should ensure that appropriate operational procedures and supervisory structures are in place with respect to both "market value" and "fair value" determinations. He emphasized that even prices provided by third parties, such as pricing services and dealers, should be subject to appropriate controls. He reminded attendees that the staff issued an interpretative letter to the ICI last year, which provided additional guidance supplementing the SEC Accounting Releases on the fair value pricing process. Roye urged attendees to "revisit their valuation policies and procedures against our recent guidance and that provided in the ICI's comprehensive paper on valuation." The Institute's paper, Valuation and Liquidity Issues for Mutual Funds (February 1997), is available at: <http://members.ici.org/p2/whitepapers/index.html>. He strongly encouraged funds to "be vigilant" in their valuation policies and procedures, and noted that this is an area that the staff will continue to pay particular attention to in the inspection process. Roye also warned that directors and managers need to be cognizant of their duties regarding best execution, and stated that the staff is looking into the practices of "portfolio pumping" and "window dressing." Roye also noted that the ICI has taken the lead in a number of areas to raise industry standards and foster best practices. In the areas of personal trading and corporate governance, for example, he pointed to the ICI's guidelines as benchmarks "against which all funds should measure themselves." Regarding corporate governance, Roye also stated that the staff's recommendations to the Commission for a final rule will reflect many of the suggestions they received in comment letters. Specifically, he noted that the staff found persuasive some of the criticism of the proposed disclosure

requirements, especially as they related to directors' family members. However, he also stated that the staff disagrees with those who objected to a rule regarding independent counsel for fund directors, and that the industry should expect to see a rule in this area. Roye also highlighted areas in which the Commission will consider proposals to improve the quality of fund disclosure. Roye stated that the Division is in the process of completing its own review of fund fees and expenses, and believes that more information regarding fees and expenses should be provided to investors. He noted that the Division expects to recommend shortly that the Commission adopt a new rule to guard against the use of misleading fund names, and to make a recommendation regarding the adoption of the rule proposal to disclose to investors the effect of taxes on the performance of mutual funds. The Division also expects to recommend that the Commission propose amendments to Rule 482 to enhance funds' ability to provide investors with better and timelier information in fund advertising. The staff will also continue studying how to improve shareholder report and financial statement presentations. In closing, Roye noted that one of the SEC's roles as primary regulator of this industry "is to challenge you to conduct your business in accordance with fundamental fiduciary principles." In meeting the challenge of increased competition, Roye asked attendees to work with the SEC to maintain the highest standards for the fund industry. David Becker's Remarks In his address, Mr. Becker provided brief updates on two recent Commission rulemaking initiatives, selective disclosure and auditor independence, and shared some lessons he has learned during his first year as the Commission's General Counsel. Regarding Regulation FD, the Commission's Fair Disclosure Rule, Becker noted that despite many dire predictions about the consequences of the rule, "the sky has not yet fallen." He acknowledged the concerns regarding the potential chilling effect of Reg FD that were raised by the ICI and other commenters, and noted that the Commission has tried to do its part to respond to these concerns. For example, in its adopting release and in subsequent staff statements, the Commission "has signaled that it does not intend to second-guess mistaken judgments about materiality in cases that are arguably close." Although Reg FD has only been effective for one month, Becker complimented the investment company industry, as well as corporate America, for its diligent efforts "to institutionalize its compliance so it can be accomplished effectively at low cost." He also noted that Reg FD is having the beneficial effect of getting people to think over disclosure issues more carefully, and that he is "optimistic that the rule will prove to be extremely useful for our markets and for investors." Becker stated that the Commission recently adopted the most comprehensive overhaul of its auditor independence requirements since the 1930s. He noted that the Commission adopted a dual approach to conflict of interest issues. In addition to requiring disclosure whenever possible, the rule also prohibits certain relationships between auditors and their audit clients. Based on his first year as General Counsel, Becker stated that he has learned that the Commission listens to thoughtful comments received by the public, noting that the Commission made substantial changes in both the Reg FD and auditor independence rulemakings based on comments illustrating unidentified consequences and providing constructive suggestions. He further stated that interaction between the industry and the Commission helps to keep the agency's limited resources focused "on issues of lasting significance to investors, rather than just the issue of the moment." Craig S. Tyle General Counsel Attachment no. 1 (in .pdf format)