

**MEMO# 11470**

December 15, 1999

## **SEC SPEECHES AT 1999 SECURITIES LAW DEVELOPMENTS CONFERENCE**

1[11470] December 15, 1999 TO: BOARD OF GOVERNORS No. 74-99 INVESTMENT COMPANY DIRECTORS No. 13-99 SEC RULES MEMBERS No. 79-99 SMALL FUNDS MEMBERS No. 19-99 RE: SEC SPEECHES AT 1999 SECURITIES LAW DEVELOPMENTS CONFERENCE

Paul F. Roye, Director of the SEC's Division of Investment Management delivered the keynote address at the Institute's 1999 Securities Law Developments Conference on December 9, 1999. SEC Commissioner Paul R. Carey 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 focused on the challenges and opportunities for the future of the mutual fund industry. He noted that learning from the past is one of the keys to doing well in the future. He therefore suggested that, as the fund industry seeks to innovate, "it would be wise both for the industry and its regulators to remember and respect the framework and attributes that have enabled the mutual fund industry to become one of the major success stories of the twentieth century." Roye noted that since its early beginnings, the industry has been able to keep conflicts of interest in check, and that the watchdog role of independent directors is fundamental to the framework established by the 1940 Act to address such conflicts of interest. He stated that strengthening that role of independent directors will be one of the Commission's key goals as regulators in the next century. Towards this goal, Roye noted that the SEC recently proposed a comprehensive package of fund governance reforms, and just issued a letter to the ICI expressing the Division's views on fair value pricing, which is one of the key tasks performed by fund directors. Roye also stated that the unique role played by a fund's independent directors has enabled the Commission to provide flexibility to the industry as it confronts the restrictions imposed by the 1940 Act, notably in issuing exemptive rules and orders permitting transactions between a fund and its affiliates. As the financial services industry undergoes consolidation on a global scale, Roye noted that the SEC increasingly will be called upon to provide the flexibility to accommodate change and will, in turn, have to rely on the funds' independent directors to help ensure investor protection. In the area of disclosure, Roye noted that the SEC plans to amend Rule 482 to eliminate the requirement that the substance of the information contained in an advertisement be derived from the statutory prospectus, and to recommend revisions to the shareholder report and financial statement requirements in order to improve these communications to shareholders. Roye further commented that the SEC will explore the concept of an "annual prospectus update," which would be a concise document provided to fund shareholders annually to inform them of material development and changes in a fund's operations. On the topic of technology, Roye stated that the SEC would work to facilitate innovation and assure investor protection as we enter the "e-century." He noted

that a joint interpretive release with the Division of Corporation Finance that clarifies and expands the 1995 and 1996 releases concerning the electronic delivery of information should be out shortly. He also assured attendees that the SEC is ready for Y2K and will “operate a command and control center to gather critical status information from fund groups and others during the last week of this month and the first week of January.” In closing, Roye urged all members of the industry to “stay ever vigilant” and be aware that just because a particular idea or innovation does not violate the federal securities laws or rules, it is not necessarily ethical or even smart. He stated that members of the industry working in compliance and legal capacities are responsible, in part, to protect their organizations, and should be “at the forefront of assuring the integrity of the mutual fund industry so that the success of the past century can be multiplied in the next.”

**Commissioner Carey’s Remarks** Commissioner Carey’s remarks focused on fund governance from the perspective of how fund investment advisers vote the securities held in their funds’ portfolios. He noted that a fund adviser has a fiduciary duty to act in the best interest of the fund when voting portfolio securities and questioned how effectively fund advisers are carrying out their responsibilities as fiduciaries in this regard. Carey stated that prior to voting and consistent with their fiduciary duties, some fund advisers may discuss with management their views on key issues that affect shareholder value, such as: (1) setting executive compensation levels; (2) repricing stock options; and (3) managing earnings through inappropriate accounting practices. He also stated that this type of an active role by fund advisers seems to be the exception, rather than the rule. Carey further noted that often fund advisers approach corporate governance issues by voting proxies according to the recommendations of proxy consultants, or by selling the stock in the portfolio if they are dissatisfied with company management. Carey also stated that fund boards can and should play a role in the voting process by communicating with their advisers to determine how the adviser is voting and making voting decisions. Additionally, he maintained that fund boards should consider providing guidance to advisers about how fund shares should be voted. He stated that most importantly, fund boards need to consider how they want voting power to be exercised in conflict of interest situations. Finally, he encouraged funds to think about what can be done to enhance funds’ voting power in order to maximize shareholder value, and to fairly recognize and address conflict of interest situations.

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