

**MEMO# 15881**

April 9, 2003

## **FINK AND ROYE REMARKS AT 2003 MUTUAL FUNDS CONFERENCE**

[15881] April 9, 2003 TO: BOARD OF GOVERNORS No. 20-03 DIRECTOR SERVICES COMMITTEE No. 6-03 PRIMARY CONTACTS - MEMBER COMPLEX No. 30-03 SEC RULES MEMBERS No. 44-03 RE: FINK AND ROYE REMARKS AT 2003 MUTUAL FUNDS CONFERENCE

Institute President Matthew P. Fink and Paul F. Roye, Director of the Securities and Exchange Commission's Division of Investment Management, each delivered a keynote address at the 2003 Mutual Funds and Investment Management Conference. Copies of their speeches are attached, and they are summarized below. Matthew Fink's Address In his address, Mr. Fink noted that the SEC staff has completed one of the busiest and most demanding years in SEC history. The industry has been working intensely to keep pace, he said, and, together, we have been dedicated to restoring investor confidence. Despite the challenges faced by fund companies and their equity fund shareholders over the past 37 months, Fink observed that the mutual fund industry continues to serve investors well. Fink offered that the mutual fund industry has earned the confidence of millions of investors because we have made protecting shareholders our first priority. Toward that end, we have resisted efforts to weaken the 1940 Act and the investor protections it offers, we have supported tough new SEC restrictions, and we have adopted voluntary standards in areas such as personal investing and fund governance. Fink pointed out that, contrary to some industries, the mutual fund industry has supported regulation when it was warranted, including support for the enactment of the Sarbanes-Oxley Act. It likewise has endorsed a series of regulatory reforms, including those relating to disclosure of portfolio holdings and fund fees in shareholder reports. However, Fink urged regulators to resist unnecessary regulation that might distort decision-making and chill innovations in a manner that would be harmful to fund investors. Fink discussed the current focus on fund fees. He cited a recent GAO report, which confirmed the existence of positive fee trends that, over the long-term, have produced substantially lower costs for fund shareholders. The report noted that, as assets in some equity 2 funds declined, the expense ratios increased slightly. Fink observed that this is consistent with earlier findings relating to economies of scale. Fink also mentioned recent letters from Congress to the SEC on various aspects of the mutual fund industry. He stated that the industry stands ready to provide information and assistance, and remains open to regulatory changes that will inform, rather than confuse, fund investors. He expressed reservations about the SEC's initiative to re-examine the desirability of creating a mutual fund self-regulatory organization. According to Fink, strong day-to-day regulation by the SEC has kept the fund industry strong and free from systemic scandal. To continue this tradition, the industry supports adequate funding for the SEC. Although effective SEC regulation and oversight are "front and center," Fink highlighted the industry's interest in other systems of regulation that may advance the interests of our shareholders. Citing as an example personal savings and retirement, Fink expressed

support for the Bush Administration's plan to simplify the system for long-term saving in this country. Similarly, he noted the industry's support for various pieces of legislation that would allow 401(k) participants to receive advice, defer taxes on reinvested capital gains until fund shares are sold, and eliminate double taxation of dividends. In closing, Fink noted that the industry has embraced comprehensive pro-investor regulation and has been a strong supporter of the SEC's mission to protect investors. He exhorted industry participants to keep up the good work. "By putting our shareholders first – in both good and difficult times – I have no doubt that our shareholders and our industry will prosper." Paul Royce's Remarks

Mr. Royce began his remarks by noting that we have recently experienced a very difficult period in the history of our nation's securities markets that has resulted in many investors losing confidence in the fairness of our markets. While there are those who would debate whether mutual funds were part of the problem, according to Mr. Royce, there is no doubt that mutual funds must be part of the solution. He noted that investors are demanding accountability and, in order to restore their trust, investors must see a new respect for honesty, integrity, transparency and accountability. Mr. Royce discussed various recent initiatives to promote responsibility and focus attention on meeting the needs of America's investors. These have included the Sarbanes-Oxley Act and related rulemaking. He noted that the Commission has striven to define the requirements of this legislation for the fund industry and ensure that fund investors benefit from the Act's tenets of fair-dealing, responsible management, and meaningful oversight. Accordingly, the Commission has adopted rules under the Act that, in part, are intended to reinforce that funds' key officers are accountable for their funds' financial statements and for their own actions and to ensure that such officers understand the full extent of their responsibilities. Mr. Royce also noted that the requirements under the Sarbanes-Oxley Act dovetail with the efforts undertaken by the fund industry and the Commission a few years ago to improve the effectiveness of mutual fund independent directors. He expressed his view that the industry should take great pride in knowing that it was ahead of the curve in recognizing the crucial role that independent directors play in promoting compliance with the federal securities laws and ensuring that investor interests remain paramount in the boardroom. He noted, however, that the important role of gatekeepers does not end with independent directors but must also include both independent public accountants and attorneys to mutual funds. Mr. Royce next discussed some of the Commission's recent rulemaking initiatives. He noted that the fund industry largely opposed the Commission requiring funds to disclose their proxy voting records. In his view, however, the criticism of the proposal largely overshadowed the fact that the Commission made significant adjustments to the proposed rules to accommodate industry concerns. Rather than questioning why mutual funds are the only institutional investors required to make this disclosure, Mr. Royce encouraged them to ask what role they can play in improving the governance of America's corporations and how the fund industry can be a leader in this area. He noted that transparency of the proxy voting process should foster investor confidence in the mutual fund industry. The next Commission rulemaking initiatives he mentioned were the pending rule proposals to improve shareholder report presentations and to modernize fund advertising rules, each of which have components designed to foster a greater level of accountability. He noted that the recent Commission rule proposal on compliance programs and compliance officers also underscores the Commission's focus on accountability. To those who question why the Commission is considering the compliance rule proposal now, he noted that the Commission wants to take steps to prevent the types of scandals that have plagued other segments of the securities industry from tainting the investment management industry. He noted that many of the Commission's enforcement cases in the investment management area are often the result of weak or nonexistent compliance controls. If adopted, the proposed rules would protect investors by improving day-to-day

compliance with the federal securities laws, while at the same time increasing the efficiency and effectiveness of the Commission's examination program. He noted that the compliance policies and procedures proposal has been largely overshadowed by the request for comment on the advisability of additional private sector involvement in promoting fund and adviser compliance with the federal securities laws. According to Mr. Roye, requesting comment on these additional initiatives does not necessarily indicate that implementing additional forms of oversight is the approach the Commission ultimately will take. Instead, the Commission believes it important to advance a public dialogue on these issues in order to determine whether the regulatory oversight scheme can be improved in the best interest of investors. In addition to rulemaking activity, Mr. Roye noted that the Commission has undertaken two other initiatives that are, in part, focused on promoting accountability in the investment management area. The first involves addressing the problems outlined in the report recently published by the Commission, the NASD, and the NYSE relating to significant failures in delivering breakpoint sales load discounts to mutual fund investors. He noted that funds have a role in ensuring that breakpoints are disclosed in a clear and understandable manner, "and fund directors have a role in overseeing how their funds are sold." He noted that a working group, which includes the Institute, the NASD, and the Securities Industry Association, has 4 been formed to address deficiencies in the current structure under which breakpoints are calculated and applied. The second initiative he mentioned is the Commission's fact finding regarding hedge funds. He noted that, for many hedge funds, the only level of accountability to which they are subject under the federal securities laws are the anti-fraud provisions enforced by the Commission and private litigants. The Commission is reviewing whether there should be greater oversight and accountability of these funds and plans to hold a public roundtable on hedge funds on May 14th and 15th. They welcome the submission of written comments on the issue. Mr. Roye next mentioned Congressional interest in the mutual fund industry. He noted that, subsequent to the recent mutual fund fee hearings held by a subcommittee of the House Financial Services Committee, SEC Chairman Donaldson received a letter from Subcommittee Chairman Richard Baker and a letter from Congressmen Paul Kanjorski and Robert Ney raising various accountability issues. These letter have requested the Commission's views, including recommendations for legislative and/or regulatory actions, on a variety of issues including fee transparency, transaction costs, soft dollars, rule 12b-1 fees, fee levels, revenue-sharing payments, fund performance disclosure, and the role of independent directors in overseeing fund fees. Mr. Roye then discussed efforts within the Division of Investment Management to improve the efficiency of their operation. He noted that the Division plans to seek permission from the Commission to implement a new exemptive application "triage" system that would eliminate full review for applications containing an attorney's certification that the relief requested is materially the same as relief previously provided to a similar applicant. The Division also plans to institute a new system of refusing to process applications that contain insufficient factual or legal analysis. Mr. Roye next noted that every fund organization must be accountable for its business decisions and the impact they have on investors. While the mutual fund industry "has an excellent record of being innovative and has created many commendable products and product features," in his view, not all new fund ideas are good for investors or the industry and he expressed concern "that there may be a herd mentality on the part of some in the industry, with some organizations taking a 'fund of the month' approach to marketing and following the latest fad in the new type of fund or feature being offered." He encouraged fund organizations to question whether new products are truly good for investors and whether they will meet a legitimate need. He challenged the industry "to ask the tough questions" and "to put on the brakes" when the fund organization "seems swept away in a tide of enthusiasm over the latest investment fad." In closing, Mr. Roye expressed his view

that, if we keep in mind that we are accountable to America's investors, the fund industry and its regulators can persevere through this difficult period in our nation's markets and restore confidence. While the fund industry "can be proud of its history of promoting a culture of honesty, integrity, transparency, and accountability and 5 also . . . of its commitment to strong fund governance and compliance practices," the industry cannot rest on past accomplishments. Instead, industry participants must continue to be leaders in the establishment of fair, ethical, and investor-oriented business practices. Marguerite C. Bateman Senior Associate Counsel Note: Not all recipients receive the attachments. To obtain copies of the attachments, please visit our members website (<http://members.ici.org>) and search for memo 15881, or call the ICI Library at (202) 326-8304 and request the attachments for memo 15881. Attachment no. 1 (in .pdf format)

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