INVESTMENT COMPANY INSTITUTE

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BARBASH REMARKS AT ICI SECURITIES LAW PROCEDURES CONFERENCE

December 23, 1996 TO: BOARD OF GOVERNORS No. 63-96 SEC RULES MEMBERS No. 83-96 RE: BARBASH REMARKS AT ICI SECURITIES LAW PROCEDURES CONFERENCE ____ Barry Barbash, Director of the SECs Division of Investment Management, delivered the keynote address at the Institutes 1996 Securities Law Procedures Conference on December 3rd. The text of his speech, entitled "This Year in Funds: The Responsibilities of Prosperity," is attached and is summarized below. Mr. Barbash first noted that 1996 has been a remarkable year for mutual funds -- based on both the tremendous growth of fund assets and the enactment of the National Securities Markets Improvement Act of 1996. He described the legislation as "a significant milestone in the history of the mutual fund industry [that] offers new opportunities for growth and innovation." Barbash cautioned the industry not to rest on its laurels, however, stating that the industrys "ability to maintain investor confidence as it continues to evolve is the key to its future success." He then focused on five areas that highlight some of the challenges the industry must confront as it looks toward the future. First, Barbash emphasized the importance of internal compliance and supervision, citing two SEC enforcement actions brought earlier this year. These actions involved allegations that a portfolio manager mispriced fund securities and that the advisory firm that employed him gave the portfolio manager too much control over the pricing process without adequate supervision. Barbash also mentioned two recent incidents involving foreign money managers and foreign securities regulators, one regarding securities allocation practices and the other concerning unusually large fund holdings of unquoted securities. Barbash stated that cases such as these "should serve as a high decibel warning to the fund industry of the critical importance of strong internal compliance procedures covering sensitive areas such as pricing and allocation of securities." Barbash then turned to the topic of soft dollars, noting both SEC Chairman Arthur Levitts recent announcement that the SECs Office of Compliance, Inspections and Examinations would undertake a special examination of soft dollar practices and the Institutes expression of support for this effort. He urged fund managers, directors and counsel to "look carefully at existing fund soft dollar practices and procedures," adding that "[t]he types of services and products paid for in soft dollars, and the effect of these payments on the prices funds pay for executions of securities transactions, warrant special attention by fund management and board members." Fund counsel, he advised, should be concerned about the legal basis underlying fund soft dollar practices. Barbash next commented on the increasing level of fund management fees. He suggested that the industry take a forward-looking approach to the level of fees, indicating that the recent increase "is hard to justify and ultimately would not seem to be sustainable by an industry that, to remain competitive, must provide better returns at lower cost that other investment options." Barbash also observed that to the extent funds experience lower performance in the future, shareholders will look more carefully at fees and whether they are consistent with the securities laws. Section 36(b) lawsuits "likely would cast a shadow on the industry as a whole," he warned. With respect to performance advertising, Barbash spoke of the importance of educating the investing public and expressed dismay about funds that overemphasize short-term performance. He referred to the Division of Investment Managements recent position confirming that a new fund can include in its prospectus past performance of other accounts similarly managed by the funds investment adviser or portfolio manager, provided that the information is not misleading. Barbash emphasized that "disclosure regarding other accounts must provide sufficient information to permit an investor to understand what the performance information is, and what it isnt." Finally, Barbash described recent SEC and Division of Investment Management initiatives aimed at achieving better mutual fund disclosure. He announced that the SEC is expected very soon to publish for comment a series of proposals designed to improve the mutual fund prospectus, implement the fund profile as an additional source of information and enhance risk disclosure. Barbash urged all industry participants to join the disclosure bandwagon, noting that the challenge of delivering better disclosure rests squarely on the industrys shoulders. In closing, Barbash suggested that the fund industry will succeed in retaining the trust of public investors if, rather than reflecting on past achievements, it looks forward and addresses issues before they become crises. Paul Schott Stevens Senior Vice President General Counsel Attachment Note: Not all recipients of this memo will receive an attachment. If you wish to obtain a copy of the attachment referred to in this memo, please call the Institute’s Information Resource Center at (202)326-8304, and ask for this memo’s attachment number: 8488.
