

MEMO# 13536

May 23, 2001

ICI 2001 GENERAL MEMBERSHIP MEETING SPEECHES

[13536] May 23, 2001 TO: BOARD OF GOVERNORS No. 24-01 PRIMARY CONTACTS - MEMBER COMPLEX No. 35-01 SEC RULES MEMBERS No. 45-01 RE: ICI 2001 GENERAL MEMBERSHIP MEETING SPEECHES Paul Roye, Director of the Securities and Exchange Commission's Division of Investment Management, Terry K. Glenn, Chairman of the Institute's Board of Governors, and Institute President Matthew P. Fink spoke at the Institute's 2001 General Membership Meeting. Copies of their speeches are attached, and they are summarized below. Paul Roye's Address Paul Roye's address focused on the following areas: (1) challenges in a difficult market; (2) the importance of valuation; (3) improving shareholder communications; (4) advertising; (5) new products and technologies; (6) affiliated transactions; and (7) after-tax returns. With respect to challenges in a difficult market, Mr. Roye cautioned funds to "be judicious when considering job cuts," noting that "cutting corners in the legal and compliance area could spell disaster for some in the fund industry." He also noted that in "a down market investors are more likely to pay attention to fee levels," and thus stressed that it is incumbent on fund managers and directors to evaluate the appropriateness of any fee increases and to ensure that they are justified. Mr. Roye emphasized that valuation is an area that is fundamentally important to the industry continuing its tradition of integrity, and stated that a recent letter from the staff to the ICI highlights a fund's obligation to monitor events that might necessitate the need to use fair value pricing to protect fund shareholders. On the topic of shareholder communications, Mr. Roye mentioned that that staff is looking at disclosure of fund portfolio holdings, with the goal of improving the quality of portfolio schedule information. He noted that the staff, in response to several rulemaking petitions, is considering the issue of the frequency with which portfolio holdings are disclosed, and that the staff will need to balance the desires of various types of investors against imposing undue burdens or causing adverse impacts on funds. One of several improvements the staff are considering is exploring the issue of making mutual fund fees more transparent to investors. 2In the area of advertising, Mr. Roye stated that the staff is "actively considering revisions to our advertising rules and exploring how to promote the use of more current performance information." He also noted that the staff has been pleased to see that recent fund advertisements have been alerting readers to market volatility and referring readers to web sites and other sources for more current performance numbers. With respect to new products and technologies, Mr. Roye noted that the staff are reviewing various web-based products, such as baskets of securities, to ensure that they are operating in the appropriate regulatory box. Additionally, the Commission plans to publish a concept release regarding actively managed exchange-traded funds to gain a better understanding of the issues surrounding these products. Mr. Roye also mentioned that the staff has been asked to consider expanding the scope of

existing rules and the adoption of new rules to provide additional relief in the area of affiliated transactions. He stated that any amendments in this area “must first recognize that Section 17 is the heart of the ’40 Act and any changes must be tested against the possibility of abuse and cannot compromise investor protection.” On the topic of after-tax returns, Mr. Roye identified two bills that would allow shareholders to defer paying taxes on fund distributions that have been introduced in the House of Representatives. Mr. Roye stated that if such legislation is adopted and it turns out that most fund shareholders are able to defer paying taxes on distributions until they redeem their shares, the staff “will seriously consider whether there is a need for funds to provide after- tax returns.” In conclusion, Mr. Roye encouraged the industry to continue the joint tradition with the SEC of “holding each other to the highest possible standards” so that we can all work towards our larger objective of maintaining the public confidence in the integrity of the mutual fund industry.

Chairman’s Report Mr. Glenn’s report focused on the state of the mutual fund industry and some basic facts about the industry and its shareholders. He stated that 2000 was a significant year for the mutual fund industry and noted that despite the downturn in the equity markets, the industry ended the year with record net new cash flow into equity funds. Mr. Glenn also stated his belief that “mutual funds will continue to be preferred by many different kinds of investors for many different reasons,” largely because the industry has always ensured that investors are placed first and that they are always protected. With respect to confronting some misconceptions about funds, Mr. Glenn highlighted the following facts about funds and fund shareholders: (1) mutual fund shareholders do not drive the stock market; (2) most fund sales are made through a third party; (3) most fund shareholders trade infrequently; (4) mutual fund investors do not panic; (5) vibrant competition has produced substantially lower mutual fund costs; and (6) market share within the fund industry is not concentrated and has changed little in recent years. Mr. Glenn concluded his remarks by noting that the industry “is a noble profession, built on both a moral and legal obligation to act as a fiduciary in serving our shareholders,” which has spawned a culture that “has earned the trust of more investors than any other financial enterprise in the history of the world.”

3President’s Report Mr. Fink’s report emphasized three areas in which the industry must, in the words of Oliver Wendell Holmes, Sr., “move in the right direction” for investors: (1) the laws that protect fund shareholders; (2) the standards the industry sets for itself; and (3) the responsibilities that come with the industry’s prominence. Mr. Fink stated that “we must never assume that yesterday’s laws and regulations are good enough for today’s shareholders.” He expressed his hope that in revising shareholder reports, the SEC would continue on its groundbreaking path of disclosure reform to “refocus these reports on matters most essential to informed investment decisions” and resist calls for fuller and more frequent disclosure of a fund’s portfolio holdings, which would “make money for traders that will come straight out of the pockets of fund investors.” Mr. Fink also stated that SEC rulemaking in the area of synthetic fund-like products is critical because “products that mimic mutual funds but avoid critical investor protections are creating serious and unnecessary risks” to the industry’s foundation of shareholder trust and confidence. Mr. Fink also noted that the industry’s voluntary practice of investor education has aided the positive and far-sighted response of mutual fund investors to the recent bear market in stocks. Additionally, fund companies continue to provide a wide array of educational services to reinforce sound investment principles, and the Institute has intensified its investor outreach efforts. In this regard, Mr. Fink highlighted the ICI Education Foundation’s “Investing for Success” program, aimed at helping middle-income African Americans become more aware of opportunities to invest for education and retirement. Mr. Fink stated that “our industry’s prominence obliges us to address important issues beyond traditional mutual fund regulation and operations.” He highlighted four specific ways in which the industry is involved in national policy debates

that affect shareholder interests: (1) supporting legislation that would allow those who provide 401(k) plan's investment options to offer advice to employees; (2) supporting the bipartisan pension reforms sponsored by Representatives Portman and Cardin and Senators Grassley and Baucus; (3) supporting measures to increase education savings, such as proposals to enhance state-sponsored 529 plans and education IRAs; and (4) working for commonsense improvements in our tax system that will help shareholders meet long-term savings and investment goals. In conclusion, Mr. Fink stressed that "to move in the right direction for investors," we must be "guided by a single beacon – an unshakeable commitment to serving the best interests of mutual fund shareholders." Doretha VanSlyke Zornada Assistant Counsel Attachments Note: Not all recipients receive the attachments. To obtain copies of the attachments to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachments for memo 13536. ICI Members may retrieve this memo and its attachments from ICINet (<http://members.ici.org>). Attachment no. 1 (in .pdf format)

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