MEMO# 10836

March 26, 1999

KEYNOTE ADDRESSES AT MUTUAL FUNDS CONFERENCE FOCUS ON DIRECTORS ISSUES; ICI ANNOUNCES ADVISORY GROUP ON BEST PRACTICES FOR FUND DIRECTORS

[10836] March 26, 1999 TO: BOARD OF GOVERNORS No. 21-99 DIRECTOR SERVICES COMMITTEE No. 12-99 PRIMARY CONTACTS - MEMBER COMPLEX No. 32-99 SEC RULES MEMBERS No. 22-99 RE: KEYNOTE ADDRESSES AT MUTUAL FUNDS CONFERENCE FOCUS ON DIRECTORS ISSUES; ICI ANNOUNCES ADVISORY GROUP ON BEST PRACTICES FOR FUND DIRECTORS ____ My opening remarks and those of SEC Chairman Arthur Levitt at the Mutual Funds and Investment Management Conference in Palm Desert, California, focused on corporate governance and the role of independent directors. Chairman Levitt proposed four measures to improve corporate governance. In addition, the Institute announced the creation of the Advisory Group on Best Practices for Fund Directors. Our remarks, copies of which are attached, are summarized below, along with a description of the Advisory Group. SEC Chairman Arthur Levitt's Remarks Chairman Levitt commented on the growth of the mutual fund industry and the responsibility that it places on industry participants generally and independent directors specifically. He discussed the recent roundtable on the role of independent directors and concluded that there was "broad agreement that the mutual fund governance structure could be and should be improved so that directors are better able to serve shareholders." He then proposed four measures that will "form the cornerstone of a major Commission initiative to improve mutual fund governance": ! First, fund boards should have a majority of independent directors. He noted that most fund families have a majority of independent directors on their boards. ! Second, independent directors should nominate any new independent directors. ! Third, outside counsel for directors should be independent from management to help ensure that directors are getting objective and accurate information. The Chairman indicated he intends to ask the Commission's Office of Compliance Inspections and Examinations to pay particular attention during inspections to the materials boards are provided. He also questioned whether directors should be concerned if the same firm acts as auditor for the fund and its adviser, particularly in situations where the auditor performs consulting services for the adviser. ! Fourth, fund shareholders should have more specific information on which to judge the independence of their funds' directors. Specifically, the Chairman noted that shareholders should be advised of a director who has business or other relationships with the adviser, as well as how much the director has invested in the fund. Finally, shareholders

should know the extent of the director’s service (i.e., how many funds) and his remuneration, although Chairman Levitt indicated that he felt service on multiple boards does not necessarily compromise a director’s independence. Chairman Levitt noted that these measures would give independent directors the tools, access and power they need to be really effective, to act as an effective check on management and to serve investors’ interests above all others. Chairman Levitt also noted the recent conflicts between independent directors and management. He vowed the SEC would investigate any claim of wrongdoing made by an independent director. He urged directors to take a look at their insurance policies to make sure they would be covered if fired by the fund’s adviser. He then touched on other areas covered at the roundtable -- soft dollars and best execution, distribution, advisory contracts, valuation procedures and disclosure. He specifically noted his concern that shareholders should receive more information on the tax effect on their investments. In conclusion, Chairman Levitt challenged the industry to do its part to enhance the effectiveness of directors. Institute President Matthew Fink’s Remarks In my remarks I commented on the success of the industry and credited common sense protections found in the Investment Company Act of 1940 -- such as redeemability, daily pricing, limits on borrowing, full and fair disclosure, prohibitions on affiliated transactions and oversight by independent directors -- with keeping the industry from serious problems. I suggested that this common sense approach should be applied in four areas of recent interest -- mutual fund governance, mutual fund disclosure, defined contribution plans and IRAs. With respect to mutual fund governance, the “watchdog” function performed by independent directors has served investors well. However, even the best systems need to be reexamined periodically and, importantly, “establishing and reinforcing high standards of professional and ethical conduct ‘starts at home’”. I announced the formation by the Institute of an Advisory Group on Best Practices for Fund Directors. The Advisory Group will identify and evaluate best practices associated with the work of mutual fund directors that the group believes should be brought the attention of every fund board. A complete description of the Advisory Group, including its members, is set forth below. I next discussed the recent common sense reforms in connection with mutual fund disclosure, namely the revision of Form N-1A and the adoption of plain English requirements, and the benefits these have for investors. The industry supports the extension of these reforms to other disclosure documents. However, vigilance will be required to avoid “disclosure creep.” I addressed the third area where a heavy dose of common sense is needed -- defined contribution plans. Complex and confusing rules undermine efforts to achieve a higher rate of retirement savings. I mentioned pending legislation that would promote portability of defined contribution plans, and would allow workers to save more by allowing increased contributions, permit after-tax contributions in some plans and give small employers tax credits for setting up plans. Lastly, I addressed Individual Retirement Accounts. The IRA had been effective in increasing retirement savings, however, the success of this simple method of savings was compromised by changes to the tax code that reduced its attractiveness. I reported that a bill has been introduced in Congress that would restore the universal IRA. Advisory Group on Best Practices for Fund Directors The Advisory Group on Best Practices for Fund Directors will draft a paper on best practices for mutual fund directors. The paper will highlight those practices of mutual fund boards that enhance the independence of the independent directors and the effectiveness of the board as a whole. The Advisory Group will include the following: John Brennan, President and CEO of the Vanguard Group and Chairman of the Institute; Robert Glauber, independent director of the Dreyfus Funds; Paul Haaga, Executive Vice President of Capital Research and Management Company; William Lyons, President and COO of American Century Funds; Dr. Manuel Johnson, independent director of the Morgan Stanley Dean Witter Family; and Dawn-Marie Driscoll, independent director of the Scudder Funds. Matthew P. Fink President

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