

MEMO# 11911

May 26, 2000

ICI 2000 GENERAL MEMBERSHIP MEETING SPEECHES

[11911] May 26, 2000 TO: BOARD OF GOVERNORS No. 30-00 PRIMARY CONTACTS - MEMBER COMPLEX No. 34-00 SEC RULES MEMBERS No. 35-00 RE: ICI 2000 GENERAL MEMBERSHIP MEETING SPEECHES

Paul Royce,
Director of the Securities and Exchange Commission's Division of Investment Management, John J. Brennan, Chairman of the Institute's Board of Governors, and Institute President Matthew P. Fink spoke at the Institute's 2000 General Membership Meeting. Copies of their speeches are attached, and they are summarized below. Paul Royce's Address Paul Royce's address focused on the impact of new technological advances on the mutual fund industry in three key areas: (i) changes in market participants; (ii) fund fees; and (iii) fund advertising. With respect to changes in market participants, Mr. Royce noted that many industry competitors are aggressively questioning the benefits of fund ownership and are trying to lure fund investors with new products, such as on-line trading. Mr. Royce cautioned that in response to this competitive environment funds will have to demonstrate that they can provide value, service and performance at competitive fee levels. On the topic of fund fees, Mr. Royce stated that competition among funds and from other financial products is going to force funds to become more sensitive about the fees that they charge. He noted that the Commission's long-standing priority to focus investor attention on the impact of fund fees prompted the Commission's recent proposal for funds to disclose the effects of taxes on fund performance. Mr. Royce mentioned that both the General Accounting Office and the Division of Investment Management are in the process of completing independent studies of mutual fund fees. Mr. Royce stated that the Commission has no desire to become the arbiter of appropriate fee levels. Instead, the Investment Company Act envisions regulating fees through standards designed to reduce conflicts of interest and full disclosure. In this regard, Mr. Royce noted that the fund governance proposals issued by the Commission last year were designed to give directors greater power to act in the best interests of shareholders, including in the review of fund fees. Finally, Mr. Royce cautioned that funds should not "respond to the new competitive environment with overly aggressive advertising." He stated that through its recent enforcement actions, the Commission has tried to send the message that the misuse of performance information to mislead investors will not be tolerated. Mr. Royce praised the ICI for its recent public service advertisements that cautioned investors not to place too much emphasis on mutual fund performance, and applauded those funds that have attempted to place 1999's extraordinary returns in proper perspective in their communications with investors. Chairman's Report Mr. Brennan's report focused on the industry's accomplishments and some of the challenges it will face moving forward. He stated that 1999 was an impressive year of accomplishment for the industry in terms of its expanding client base, growing assets, and significant cash

flow. Mr. Brennan noted that the industry's progress on fund governance, particularly the Report of the Advisory Group on Best Practices for Fund Directors, which extends well beyond current law and practices, represents a significant accomplishment in 1999. With respect to the future, Mr. Brennan highlighted several areas in which the mutual fund industry will continue to face challenges: (1) Investor Expectations – the industry must continue to emphasize to investors the importance of reasonable expectations; (2) Benefits of Funds – the industry must do a better job of defining its fundamental value proposition of sound investment products and exceptionally good service at a fair price; (3) Investor Base – the industry should continue to focus on broadening its shareholder base to reach out to different segments of the population; and (4) Asset Velocity – annual redemption rates for stock funds increased in 1999, even though constant trading activity in mutual funds is perilous both for those who engage in it and long-term shareholders. Mr. Brennan concluded his remarks by noting that the industry's greatest challenges and opportunities in the coming years will relate to technology, a "double-edged sword" that poses "great hazards" for investors while also offering opportunities for innovative products and services.

President's Report Mr. Fink's report emphasized that the industry's ability to carry its tradition of integrity forward in a time of extraordinary change requires it to embrace change without abandoning the basic principles that have been instrumental to its success. Mr. Fink discussed three examples that demonstrate how the Securities and Exchange Commission has effectively made use of its authority to serve evolving shareholder needs: (1) the creation in the early 1970's of money market funds with one dollar per share net asset values; (2) the adoption of Rule 482 in 1979, which permitted funds to advertise performance; and (3) the 1998 overhaul of many of the rules governing fund prospectuses and the adoption of the fund profile rule. Mr. Fink noted that these examples illustrate that the mutual fund industry must constantly identify and work for regulatory innovations that allow it to better serve shareholders. Mr. Fink also noted that "it is equally vital that we oppose change that would harm shareholders' interests" by safeguarding the core protections of the Investment Company Act. In this regard, Mr. Fink highlighted the Institute's opposition to a 1999 proposal that effectively would have repealed Section 17(a) of the Act, which prohibits principal transactions between a fund and its affiliates, and the Institute's success in ensuring that hedge funds received narrower exemptions from regulation under the Act in 1996 than were being called for. Mr. Fink also highlighted several examples that illustrate the Act's continued vitality, including: (1) the Commission's proposed rules to modernize and strengthen key elements of the fund governance provisions of the Act, as well as the best practices report for fund directors; (2) the implementation of the historic Gramm-Leach-Bliley legislation that repealed the Glass-Steagall Act and modernized the regulation of American financial services; and (3) the Commission's roundtable to examine the regulation of investment advisers. In conclusion, Mr. Fink stressed that "to meet our shareholders' needs, our business practices must change, but our business principles must not."

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