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ICI President Calls on Fund Industry to Maintain Tradition of Integrity, May 2002

ICI President Calls on Fund Industry to Maintain Tradition of Integrity
Washington, DC, May 23, 2002 - Investment Company Institute President Matthew P. Fink today told mutual fund industry leaders that their most important responsibility is to continue the tradition of integrity that has been the industry's hallmark for more than 60 years.

"There is only one way to ensure the continued integrity of our industry. That is to judge every action we take by one criterion and one criterion alone—whether it is in the best interests of fund shareholders," Fink said during an address at the Institute's annual General Membership Meeting. The Institute is the national association of the investment company industry. Its members include mutual funds, closed-end funds, and sponsors of unit investment trusts.

Shortly after the Investment Company Act of 1940 was enacted, the Institute's first head, Paul Bartholet, predicted that the mutual fund industry would succeed if it remained singularly focused on serving fund shareholders. "Bartholet urged us to take an active, pro-consumer approach to regulation. He advised us to work with, not against, legislators and regulators who are concerned about the needs of fund shareholders. And he counseled members of our industry to put aside their differences and work together in support of high standards that served the interests of fund shareholders," Fink said.

Today, Fink said, Bartholet would acknowledge that the fund industry has consistently worked together to embrace strong regulation that puts mutual fund shareholders first. "We have not let the consumer protections of the Investment Company Act become watered down," Fink said. "We have resisted calls over the years, in good times and in bad, to roll back the Act's safeguards. Today, the Act's strict investor protections remain fundamentally unchanged from 60 years ago."

Fink urged the industry not to rest on its laurels. He called for industry leaders to continue to support and protect the 40 Act's core safeguards, which he said underlie continued investor confidence in mutual funds These safeguards include diversification requirements; prohibitions against self-dealing; the requirement to mark all assets to market every business day; tough limits on leveraging; full and fair disclosure; and oversight by independent directors. Fink also noted that the 40 Act's authors anticipated that the economy would evolve, and included in the statute authority for the SEC to modernize rules and regulations to serve changing shareholder needs. He identified several areas of the Act in need of refinement, including those dealing with disclosure requirements. Fink called for the SEC to continue its movement toward reorienting disclosure requirements to focus on conveying useful, practical and concise information. The SEC recently proposed important changes to mutual fund advertising rules and Fink said this “same successful logic should next be applied to shareholder reports.”

Fink also renewed the Institute’s call for the SEC to reconsider the need for regulatory disclosures filed on Form 13F. Fund companies are required to list most of the equity securities held by their funds each quarter. Although the SEC no longer appears to need these filings, they are posted on the agency’s website. Considerable evidence suggests that professional traders rapidly download this information to identify securities that funds may be buying or selling. “The inescapable conclusion seems to be that 13F filings fuel abusive practices like frontrunning and free-riding that harm fund shareholders,” Fink said.

Fink suggested there are continuing efforts by various groups to secure exemptions from the 40 Act that are unwarranted and unwise. He specifically referred to calls to allow hedge funds to advertise, conduct public offerings, and be available in 401(k) plans. “We’ve witnessed an alarming increase in serious problems

for investors in unregistered hedge funds,” Fink said. “Despite these warning signs, some are suggesting that unregistered hedge funds should be given even more of a green light. In my view, this is a recipe for potential disaster.” Instead, he called upon policymakers “to evaluate the activities of unregulated hedge funds and impose tough corrections on abusive practices.”

Advancing the interests of fund shareholders also requires support for reforms that make financial markets fairer and more efficient. Fink noted that the fund industry had devoted considerable attention to promoting improvements in the structure of the nation’s equity markets. He also said that the industry was leading efforts to require improved disclosure for municipal securities.

Fink described two recent efforts to protect the interests of fund shareholders. First, in a submission to the New York Stock Exchange, the Institute reiterated its long-standing position that most stock option plans should be subject to shareholder approval. The NYSE should adopt this approach, Fink said, “because if these plans are not subject to appropriate checks, they can have the effect of transferring wealth or voting power from public investors to management.” And second, Fink reported that the Institute urged the SEC to eliminate the time gap between a company’s public earnings announcements and the filing of its financial statements. “Mutual fund managers are encountering far too many situations in which companies report earnings with great fanfare but limited detail,” Fink said. “Then, after several weeks and much activity in the market, the data that reveals what the announcement did—and did not—account for is finally provided.” The SEC has recognized the problem and has proposed to shrink the time gap, but Fink said the SEC “should go further to attempt to eliminate the gap entirely.”

Fink noted that among the lessons learned from the Enron bankruptcy is that participants in 401(k) plans need to be fully informed about their plan’s investment options. “Disclosure reforms are pending in Congress, and we look forward to working with Congress and the Department of Labor to design a stronger and more useful 401(k) disclosure system,” he said. Many 401(k) participants also want advice to help evaluate their investment options and Fink said he is hopeful that pending legislation to allow plan service providers to offer reasonable and prudent advice to plan participants—subject to strict fiduciary regulation and full and fair disclosure—will become law soon.

Fink said that Congress and the states had taken actions of historic importance with respect to encouraging saving for education, but that these new programs presented new issues that needed to be addressed. He said that the Institute has recommended that the Municipal Securities Rulemaking Board develop a disclosure requirement informing investors that while out-of-state 529 college savings plans often are appropriate and attractive investments, there may be a tax advantage to investing in their own state's program. Fink noted surveys that have found that saving for college ranks only behind saving for retirement as a goal for mutual fund investors, and that "these programs may someday be seen as significant as the establishment of IRAs and 401(k) plans."

Fink stressed the importance of constantly reinforcing investor awareness about all aspects of mutual fund investing. "We must continue to educate investors about the risks, as well as the rewards, of investing. We must continue to describe our products and services to investors clearly and coherently. We must constantly remind investors about the benefits of diversification; about the importance of interest rate changes on bond funds; about funds' lack of FDIC insurance; about appreciating how expenses and taxes can affect returns; about focusing steadily on long-term goals—in short, about all aspects of mutual fund investing," he said.

"Our job is far from finished," Fink said. "The years to come will present many challenges. So long as we devote ourselves to maintaining the integrity of our industry, I have no doubt that the future will be bright for our shareholders, and therefore for ourselves."
