

SPEECH

May 4, 2011

Fostering the Next Generation of Investors

Fostering the Next Generation of Investors

ICI Chairman's Address

53rd Annual General Membership Meeting

Edward C. Bernard

**Chairman, Investment Company Institute, and Vice
Chairman, T. Rowe Price Group Inc.**

May 4, 2011

Marriott Wardman Park Hotel
Washington, DC

As prepared for delivery.

Thanks, Greg, for that introduction. And thank you for your leadership in chairing the volunteer committee that organized this year's General Membership Meeting. I had the honor of holding that job three years ago, so I know how much work and dedication goes into planning a meeting on this scale. We all thank you and your committee for this great program. GMM is the fund industry's can't-miss meeting of the year, and this year, that's more true than ever.

We certainly have no shortage of important issues to discuss.

You know, it's been almost four years now since the financial crisis started, with breakdowns in mortgage-backed securities and the failure of a British bank called Northern Rock. And it was 32 months ago that Lehman Brothers failed, with a huge financial and economic impact for so many, including our industry.

We've been coping with the fallout ever since—in our economy, in our financial markets, and in our own companies.

The turmoil that we endured also affected our investors. They have been challenged to progress toward their financial goals even as markets have twisted and turned. For the most part, even in the face of considerable fear and uncertainty, they stayed the course—as I'll discuss later.

This has been an experience that none of us will ever forget. It will influence the judgments we make and the actions we take for the rest of our careers.

And it isn't entirely over.

Our lawyers continue to burn the midnight oil to cope with a flood of new rules and studies required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Our industry leaders are working hard to advance ideas that will make money market funds even more resilient under the worst financial conditions. They'll be discussing those measures at a roundtable at the Securities and Exchange Commission next week, and at ICI's Money Market Funds Summit on May 16.

Let's also give credit to our regulators. During and since the crisis, we've seen tireless and thoughtful effort from many public servants at the SEC, the Treasury, and the Federal Reserve, as well as legislators and staff on Capitol Hill. While our respective roles sometimes lead to debate about approach, we recognize that they share our goal of advancing the interests of investors.

Our shareholder and client relations teams are building on the extraordinary efforts made during the crisis to help investors cope with these turbulent markets. For example—I'm sure most of you have received client letters such as one we recently received at T. Rowe Price commending one of our service reps, and I quote: "He went through an in-depth discussion to know us and properly assess our needs. He reviewed our portfolio and determined we had more risk in our selections than was necessary to achieve our goals. What he really did was give us peace of mind."

Another vital way we serve investors is by navigating complex financial markets on their behalf. Our trading desks are learning to cope with rapid and sweeping changes that have transformed market structure and trading practices—including new technology and global competition that has reshuffled our trading venues. Events like the "flash crash," almost exactly a year ago, have highlighted inefficiencies in market structure that can harm funds and their investors. ICI has engaged deeply with regulators to address those problems.

And, of course, our portfolio managers are dealing with uprisings and hopes of democracy in the Arab world...with disasters in Japan...with debt crises in the Eurozone...with gyrating oil prices—a world of turmoil that they must negotiate on our investors' behalf.

I don't know about you, but the events of the past couple of years have given me occasion to step back from it all and observe:

This is what history looks like when you're actually living it.

For the past year and a half, I've had the good fortune to have a front-row seat on history as our industry deals with these trials. As Chairman of the Institute, I've watched ICI's staff and ICI's members rally together to serve our investors and, in collaboration with regulators, to help shape policies for the benefit of our nation. Professionals throughout our industry have brought their talents and dedication to bear in a collaborative effort to address the most challenging policy agenda we have faced in decades.

And those efforts have been rewarded. Building on the core strengths of our product and our fiduciary culture, ICI is helping our industry emerge from the crisis and its aftermath.

Congress recognized that the financial crisis wasn't about funds—and so Dodd-Frank left intact the core of our business and our regulatory structure. There aren't many others in the financial industry who can say that.

The Financial Times wrote last year, "Of all the industries operating within the financial sector, the one sustaining the least damage from the 2008 subprime/Lehman/Great Recession meltdown is probably the U.S. mutual fund industry." That's a remarkable tribute to the fundamental strengths of funds, their advisers, and their boards.

As we look ahead, we see what ICI General Counsel Karrie McMillan recently described as "sunlight through the clouds." Our work isn't finished—but we know we are emerging from the crisis, with the structures we have to serve investors intact, and with strong prospects for the future.

So now, I want to turn to another challenge—one that's no less significant than those we've faced in the past four years.

That is the obligation we have to ensure that Americans continue to have the opportunities and incentives to participate in our financial markets.

For investors, the financial meltdown of 2007 and 2008 created sharp setbacks. While the gains of the past two years have largely offset those losses, many investors have had to examine their strategies for retirement and other financial goals. They've reassessed their attitudes toward risk and their approaches to investing.

We've talked with our shareholders through our call centers, retirement plan sponsors, and financial advisers as they've made these changes. We've seen the traffic on our websites as investors study their portfolios and their investment choices. And I suspect we've all shared the pain of friends, relatives, and neighbors who want help in finding the best way forward.

These changes are also showing up in ICI Research.

Across a wide spectrum of ages, investors have a reduced appetite for risk. Fewer investors say they'll take above-average or substantial financial risk in exchange for comparable returns. Among households owning mutual funds, the share willing to take such risks has fallen by almost one-fifth—from 37 percent to 30 percent—since 2008.

ICI Research asked Americans last winter how they had changed their investment strategies in response to the economic stresses and volatile stock market experience of the past three years. Nearly three out of five households with financial assets said they had:

- increased their regular saving amount;
- delayed the age at which they will retire; or
- shifted their investments to a more conservative mix

And we can see that caution in our industry data. Since the bear market, flows into domestic equity funds have been weaker than market history would predict. At the same time, flows into bond funds have been stronger than expected. While there are many reasons for this shift, investors' reduced tolerance for risk is clearly part of the story.

What's particularly striking is that these trends seem to be strong among Americans born in the 1970s—today's 30-somethings. These young adults came of investing age in a daunting

decade, starting with the tech-stock bust and ending with the financial crisis. And you can see the results in their financial behavior.

Today's 30-somethings are less willing to take investment risk than their counterparts born in the 1960s—the cohort now in their 40s.

And this group is shy about investing in stocks. Consider this: in 2010, the share of households that own stock among 30-somethings was lower than in any other cohort born after the Great Depression.

Now, it's hardly surprising that the market turmoil of recent years has made investors more cautious. Investors' decisions to save more, save longer, and take fewer risks are a rational response.

But that trend toward caution underscores the heavy obligation that we face—as an industry—to help all Americans save, invest, and manage toward their financial goals.

Because we can be pretty certain that younger Americans—including these 30-somethings—will be called upon to be more self-reliant than older generations.

We'll hear a lot this week about our nation's budget and debt problems. Treasury Secretary Timothy Geithner, former Senator Alan Simpson, and former White House Chief of Staff Erskine Bowles will all address the current debate over reining in deficit spending and the rapid growth of the national debt.

It's a timely debate. Treasury's borrowing is projected to hit the national debt ceiling later this month. The debate over extending the ceiling has brought forward competing visions for our nation.

As major players in the U.S. financial markets, we would urge Washington to come together to maintain the government's ability to borrow, while putting our budget on a more sustainable course. Our markets and our economy cannot afford to take chances with Uncle Sam's creditworthiness.

For the longer term, it's just as important that our nation gets its debt under control. Whatever you think about the politics...whatever your opinion of government spending, entitlement reform, or taxes...one outcome seems likely: Americans are going to need to save more, invest more, and take more responsibility.

In the future, personal savings will need to carry more of the weight.

And we—the fund industry—need to do all we can to help Americans gather those savings and manage them wisely.

It's a big challenge.

Fortunately, we have three solid pillars to build upon as we confront this challenge:

- Our history;
- Our investors' confidence; and
- The core strengths of our funds

The first pillar is our history. We have achieved great progress in educating investors before. In 1980, roughly 5 million U.S. households owned mutual funds. Today, more than

50 million households own mutual funds. America is a nation of investors in no small part because of the fund industry's efforts.

Over the decades of the 1980s and '90s, funds helped Americans learn two simple lessons:

- You need to save—to put money aside; and
- You need to invest—to put that money in assets with the opportunity to grow faster than inflation

Over that 20-year period, the collective weight of the fund industry's educational efforts played a major role in driving those lessons home. We had help, of course, from the rapidly growing financial media and from employers adopting that new retirement vehicle, the 401(k) plan. But it was the combination of these educational efforts with the elegantly simple and sound investment vehicle called a mutual fund that transformed Americans from savers to investors.

The evidence of our progress for investors lies in the confidence they have shown—the second pillar upon which we'll meet the challenge of helping Americans save and invest.

In every market downturn, the pundits and the media experts have predicted that mutual fund investors would panic and abandon their long-term investing goals. They predicted a rush for the exits in 1987...in 1990...in 2000. And they're still looking for it today.

Guess what? Investors have stuck with their long-term financial plans.

In fact, the past two bear markets reinforced the lessons about saving and investing.

Saving matters. At T. Rowe Price, we surveyed consumers in December 2008—when the stock market had fallen by about 40 percent from its peak. When we asked Americans what they were doing in response to the crisis, two of the most common responses were, "I have been spending a bit less" and "I have been saving more."

To me, that means that investors realize that saving is the lever over which they have the most control when it comes to meeting their financial goals.

And investing matters. When the tech bubble burst in 2000, triggering what was at the time the worst market downturn in a generation, retirement savers' commitment to stocks declined only slightly, from 75 percent of their portfolios in 2000 to 67 percent in 2003. In T. Rowe Price's research, investors told us they needed to stick with equities as their best means of beating inflation.

In the face of the more-recent financial crisis and subsequent bear market, retirement savers once again remained relatively calm. Since 2008, ICI has tracked the behavior of a large sample of participants in defined contribution plans—more than 22 million accounts. Every year, more than 95 percent of 401(k) savers kept contributing and avoided withdrawals. And participants were no more likely to change their asset mix than they were before the downturn.

Through the worst bear market since the 1930s, retirement savers have stayed the course. Once again, the people who invest were a lot calmer than the people who write about them.

There's another message in these results: investors were served by the core strengths of

our funds.

Those strengths are our third pillar as we confront the savings and investing challenge. Because there's no better vehicle than mutual funds for average investors to achieve their financial goals.

When investors buy a mutual fund, they receive a diversified, professionally managed portfolio that's transparent and liquid.

That fund has a simple capital structure and limited use of leverage—a strong structure that kept funds out of the traps that caught many other financial products in the crisis.

The fund's assets are held under safe custody, and their value is marked-to-market every day, following strict pricing discipline.

These protections are backed by comprehensive disclosure requirements and rules to manage conflicts of interest. Every fund is subject to strong governance, with independent directors serving as watchdogs for the interests of investors.

Overarching all this is the fiduciary culture of our industry. We must never forget to put shareholders and their interests first.

Within that system of investor protection and fiduciary duty, our companies have pursued a tremendous range of innovations. We've created products that serve a wide array of investor needs—money market funds, index funds, lifestyle and target date funds, and exchange-traded funds.

And our industry has fostered growth and competition. The cost of investing in stock and bond funds has fallen by half since 1990. Indeed, the U.S. Supreme Court, in its unanimous decision in *Jones v. Harris*, validated the key roles of competition and director oversight in setting funds' fees.

Our time-tested regulation, oversight, and fiduciary duty carried our investors through the deepest bear market since the 1930s.

So let me lay down some challenges to all of you—to all of our industry—today.

We must reach out to our investors—and to those who should be investing to meet their future financial needs.

We must offer financial education to foster that younger generation whipsawed by two bear markets. We need to help them understand the power of long-term investing to overcome short-term setbacks and to outrun inflation over time.

We must pursue policies that preserve and extend the incentives to save and invest that Americans rely upon. Among other things, that means demonstrating to policymakers that the tax incentives for 401(k) plans and individual retirement accounts make our country stronger.

We must continue to serve our investors wisely and well—to give them the efficient and effective professional management they seek, always putting their interests first.

Finally, we must use our knowledge of how investors think and behave to design new

products and services that will help them achieve their goals.

If we meet these challenges—and if we always keep our shareholders first—we, and our investors, can look forward to a future that is bright indeed.

Thank you.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.