

## **SPEECH**

March 25, 2002

# **2002 Mutual Funds & Investment Management Conference: Keynote Address**

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## **Keynote Address**

**Matthew P. Fink**

**President, Investment Company Institute**

March 25, 2002

Orlando, Florida

Good morning. It's my pleasure to welcome you to the 2002 Mutual Funds and Investment Management Conference, our thirty-seventh annual meeting. I'm pleased to be here with Paul Royce, the Director of the SEC's Division of Investment Management.

The mutual fund industry has always been a strong supporter of the SEC's investor protection mandate. Paul and his staff—and the SEC's new Chairman, Harvey Pitt—can count on our continued support in the months and years ahead.

The year that has passed since our last conference has been a very difficult one. The shocking events of September 11, our heightened awareness of the vulnerabilities of a free society, and our nation's war against terrorism have tested our mettle in ways that were unimaginable just a few months ago.

Many tenants in the World Trade Center were in the securities business. Several were mutual fund companies. We lost many friends and colleagues on that terrible day. We will never forget them, or the men and women who died trying to save them.

The financial markets and individual investors have not been immune from the troubles of the past year. An 18-month bear market had already eroded the value of stock holdings by about 25 percent when the Pentagon and the World Trade Center were attacked. At one point before September 11, the Dow was nearly 20 percent below its high of a year earlier, the S&P 500 was off by 29 percent, and the NASDAQ had fallen by nearly 68 percent. More recently, the circumstances surrounding the Enron bankruptcy have caused additional uncertainty.

Considered in this difficult environment, the mutual fund industry was fortunate to end 2001 with total [fund assets virtually unchanged](#) from the prior year. Reflecting the weakness in stock prices, equity fund assets fell significantly, but the drop was offset by increased assets in money market, bond, and hybrid funds.

While many equity fund shareholders suffered significant losses in last year's difficult environment, the evidence indicates that the diversification inherent in mutual funds cushioned fund shareholders from the more severe losses experienced by individual stocks.

More important than these indices and averages, however, was the fact that equity fund investors reacted calmly and rationally in the face of volatile and uncertain market conditions. There were no mass redemptions. There was no panic. In the midst of the sharpest downturn in more than 25 years, [fund shareholders](#) once again demonstrated that they are long-term investors.

The steadfastness of mutual fund investors is no accident, but rather is the direct result of actions that our industry has taken over the past 60 years.

The abuses that occurred in our industry in the 1920s and 30s taught us that tough and meaningful investor protection is essential to investor confidence. We have not wavered since. During both bull and bear markets, we've resisted the siren song that strict regulation is outdated and no longer necessary. We have a long history of supporting strong laws and regulations, of encouraging informed investors, of supporting clear and useable disclosure, of working for [adequate resources](#) for the SEC, and of imposing upon ourselves high voluntary standards that go well beyond legal requirements.

Sixty years ago, Paul Bartholet, the first head of the Institute, gave a major address on fund regulation and the importance of putting shareholders first. Bartholet was well aware that his remarks were being delivered in the midst of World War II. He said:

"It seems strange that we should be meeting to discuss regulation at a time when millions are fighting for the preservation of our freedom."

Bartholet went on to state that:

"We are justified in being here only if we join together for the better performance of a task all-important to our democracy—the trusteeship of the family savings of this country."

Bartholet's words resonate. Now, as then, our nation is engaged in a difficult, dangerous, and noble worldwide war. Now, as then, "the trusteeship of the family savings of this country" is in our hands.

Today more than half of American households depend on us to serve as the trustees of their family's savings. One of the most important ways we fulfill this responsibility is by constantly re-evaluating the regulatory framework governing mutual funds to ensure that it continues to serve and protect our shareholders.

This morning, I will discuss five current legislative and regulatory topics—restrictions on market timers; improvements in disclosure; [tax relief](#) for long-term fund shareholders; mutual funds' role as investors in the market; and [investment advice](#) for 401(k)

participants.

First, the problems created by market timers. In recent years, more and more funds have been used by short-term traders as a way to obtain quick profits by frequent trades in and out of funds. This short-term trading technique can adversely affect long-term investors. To protect their long-term shareholders, some mutual fund groups are considering imposing limits on exchange privileges between funds. These limits would be fully disclosed, and shareholders would, of course, be free to redeem their shares at any time.

This is not a small problem. The assets of millions of individuals who invest in mutual funds for their long-term goals are being targeted by short-term speculators. We understand that the SEC is reviewing industry practices. We urge the Commission to allow fund companies to protect their long-term shareholders from market timers.

Second, improvements in disclosure to investors. Good disclosure promotes understanding and comparability. We recently worked with the SEC to greatly improve and simplify mutual fund prospectuses, an effort widely viewed as a substantial success. But with more than half of all households investing in mutual funds, much more can and should be done. I'll briefly describe measures to improve disclosure to individual investors in four areas—[shareholder reports](#), [401\(k\) plans](#), fund advertising, and 529 college savings plans.

There is broad agreement that mutual fund shareholder reports could be made more useful to investors. One way to accomplish this is to include better analytical information about the fund's overall characteristics. A pie chart that breaks out the portfolio by industry sector, market capitalization, and geographic region is just one of many ways to accomplish this.

Shareholder reports could also be improved if we are willing to take a hard look at the [disclosure of portfolio holdings](#). Shareholder reports should list the fund's largest holdings, and shareholders should be able to receive the report's full list of portfolio holdings if they choose. But continuing to require that every shareholder be sent a list of the entire portfolio twice each year fails to enhance understanding or improve comparability. What it does produce is millions of unread pages and wasteful printing and mailing costs.

An across-the-board requirement that portfolio holdings be provided more than twice annually also makes little sense. While many mutual funds do so voluntarily, there is significant [evidence](#) that some funds are targeted for abusive trading practices by those who exploit portfolio disclosures intended for fund shareholders and SEC regulators. This problem would be exacerbated if the SEC mandates monthly or quarterly portfolio disclosures for all funds. We urge the SEC not to inadvertently encourage practices whereby speculators are able to profit from money management services paid for by fund shareholders. The interests of fund shareholders and fund managers are perfectly aligned on this question, a sharp contrast to outside free-riders, whose profits from this information come at the expense of mutual fund shareholders.

401(k) disclosure is also in obvious need of improvement. The Enron scandal has reminded all of us that participants in 401(k) plans need to be fully informed about their plan's investment options. The Institute has long [called for action](#) in this area. Disclosure reforms are now pending in Congress, and we look forward to working with lawmakers and the Department of Labor to design a stronger and more useful 401(k) disclosure system.

Another disclosure improvement concerns mutual fund advertising. Current SEC rules require performance information to be current to the most recent calendar quarter. But this information can become dated, especially in publications with a long “lead time.” We have recommended that the SEC require performance advertisements to disclose how investors can obtain information that has been updated to the most recent month-end. Performance advertisements would be required to include a web site or toll-free number where this updated information would be disclosed.

Finally, most states have moved quickly to offer 529 plans to help families support their children’s higher education. In fact, saving for college ranks behind only saving for retirement as a goal for mutual fund investors. Many plans provide a state tax advantage when residents invest in their own state’s 529 plan. While out-of-state plans may be suitable or attractive alternatives, we believe that investors should be alerted to the potential tax advantage of their own state’s program. For this reason, we believe that 529 offering documents need to include prominent disclosure in this area.

It is not uncommon for us to face a broad range of disclosure questions, and this brief summary suggests that is obviously true today.

A third area of the regulatory framework governing mutual funds that should be reexamined concerns the taxation of long-term fund shareholders. We owe it to our shareholders to ensure that the nation’s tax policy does not needlessly impede their ability to achieve long-term investing goals. For that reason, 90 mutual fund industry leaders recently [urged Congress](#) to enact legislation that would permit mutual fund shareholders to defer taxes on reinvested long-term capital gains distributions.

Under current tax law, fund shareholders must pay an annual capital gains tax even though they have not redeemed fund shares or taken any action to realize capital gains. Deferral would benefit millions of middle-income Americans, encourage investment in the U.S. economy, and stimulate long-term economic growth. Over the long term, deferral would not significantly reduce the government’s revenue. It would simply allow shareholders to defer paying taxes on distributions until they redeem their shares.

Given the return of the federal deficit, it may be difficult to enact legislation quickly. But we must continue to work for this important reform.

My fourth topic concerns the role mutual funds play as investors in stocks, bonds, and other securities. As mutual funds have grown in popularity and size, the industry has become increasingly active on a range of issues related to their status as significant investors in our capital markets.

Individual funds often participate actively in matters involving individual portfolio companies, for example, by voting proxies and meeting with corporate management. In addition, the Institute serves as an advocate in legislative and regulatory arenas for the collective interests of funds as investors in a broad range of securities. We have worked for improvements in the structure of our equity markets; we have proposed improved disclosure in the municipal securities market; and we have urged the New York Stock Exchange and NASDAQ to provide for [greater shareholder participation](#) in approving corporate stock option plans. The Enron bankruptcy has prompted a large number of additional legislative and regulatory proposals in this area, and we are carefully reviewing

and monitoring them. As in the past, we will examine these matters with the goal of best serving the interests of mutual fund shareholders. I have no doubt that this approach will lead us to continue to press for improvements in market structure, issuer disclosure, and corporate accountability.

A moment ago I mentioned the need for better disclosure to 401(k) plan participants. My final topic this morning also concerns 401(k) plans—the ability of millions of plan participants to obtain investment advice.

Today, 42 million Americans have an estimated \$1.8 trillion invested in 401(k) plans. Mutual funds account for about 43 percent of 401(k) assets, with insurance and bank products and company stock accounting for the majority of assets.

Many 401(k) participants want and need advice to help them decide how to invest their 401(k) balances. The Institute and many individual fund groups provide a wealth of information about the importance of retirement savings, and identify key issues for 401(k) investors to consider. Estimates vary, but clearly the vast majority of 401(k) participants do not have an investment advisory service available to them through their plans. This situation contrasts sharply with the use of advisors by mutual fund investors generally, where a majority depends on a professional advisor in making investment decisions. Clearly, an “advice gap” exists in the 401(k) market, and an expansion in advisory services for 401(k) participants is needed.

Ironically, the 1974 pension reform law, ERISA, has been interpreted to prohibit participants from receiving investment advice from the very institutions that are in the best position to supply it, the providers of investment options to participants.

Fortunately, a strong bipartisan majority of the House of Representatives has passed [legislation](#) introduced by Chairman Boehner that would permit these firms to provide advice to plan participants. The legislation subjects firms that choose to provide such advice to strict fiduciary regulation and full and fair disclosure. We are pleased that President Bush endorsed this bill as part of his pension reform package. I hope that this needed reform will soon become law.

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In conclusion, in his 1942 speech, Paul Bartholet—standing before a vastly smaller industry—called upon us to fulfill our role as the trustees of the family savings of America. For over 60 years, we have honored this commitment by placing the interests of fund shareholders above all else. This enduring commitment to fund shareholders has been the key to our success.

The worst mistake we could ever make would be to rest on our laurels. In every area that affects our shareholders, the mutual fund industry has an obligation to play an active and constructive role.

We must seek regulatory changes as needed to update the 1940 Act to meet new conditions. We must oppose efforts to dilute the core investor protections of the Act. We must work vigorously for legislative and regulatory changes in other areas—retirement, education, taxation, and corporate governance—that affect our shareholders’ interests.

And, our support of strong, pro-consumer regulation is only part of the picture. We must

continue to educate our officers, employees, and directors to implement the spirit, as well as the letter of the law. We must continue to educate investors about the risks, as well as the rewards of investing, and about the importance of a long-term perspective. We must continue to vigilantly guard our industry's commitment to fairness and integrity, and to set the highest possible professional standards for ourselves beyond the legal requirements that bind us.

I have no doubt that the future will bring us many problems and many challenges. But, if we remain true to our traditions—if we continue as the unwavering trustees that Paul Bartholet urged us to be—I have no doubt that our future will be bright.

Thank you.

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