

## **SPEECH**

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# **Our Commitment to Advancing the Interests of Investors**

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## **54th Annual General Membership Meeting**

**Paul Schott Stevens**

**President and CEO**

**Investment Company Institute**

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Marriott Wardman Park Hotel

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As prepared for delivery.

Thank you, Mellody. We all owe a huge debt of gratitude to you for the outstanding leadership you’ve shown in chairing the volunteer committee putting together this year’s program. At every turn, you challenged us to think bigger and reach higher, and you brought your own remarkable energy to every aspect of this year’s meeting. You’ve set a high bar indeed for future GMM programs.

Good afternoon, and welcome to all of you. We’re looking forward to an exciting three days filled with new insights and thoughtful interactions. It promises to be our best GMM ever.

Mellody got our meeting off on the right foot by focusing on our obligations to investors in helping them meet their financial goals. She has challenged all of us to step up our efforts to provide financial education, to ensure investors have access to sound advice, and to rise to new standards of investor service.

Mutual fund shareholders expect much from us—and rightfully so.

In turn, we owe them nothing less than the undivided loyalty and high degree of care that are the hallmarks of a fiduciary. In our stewardship of fund investments, in our conduct as fund directors and officers, and in the services we provide fund shareholders—our unwavering objective must be to meet the high expectations that fund investors have of us, and to earn their trust.

That same obligation carries over to the public policy positions we support collectively through ICI.

ICI's mission calls for the Institute to "advance the interests of funds, their shareholders, directors, and investment advisers."

Who does ICI represent? Open our Fact Book, and the answer is there: More than 9,000 funds serving more than 90 million shareholders, who have entrusted us with \$13 trillion in assets.

Paul Haaga, now Chairman of Capital Research and Management, is retiring from our Board after 18 years of distinguished service—including as Chairman of the Institute during the dark days of 2003 and 2004. At that time, Paul said [QUOTE]: "As soon as shareholders don't come first, mutual funds won't be the investment of choice—and we won't deserve to be."

One result of putting shareholders first is that ICI and its members have always taken an affirmative approach to regulation.

After the great stock market crash of 1929, fund sponsors that survived the carnage realized that funds could never thrive without the public's trust and confidence. And they knew that the key to gaining that trust would be sound, investor-centered regulation.

And so the fund industry came together to support the Investment Company Act of 1940, the landmark legislation upon which we've built our industry. Seventy-two years later, we're still working to support regulation under that Act and other laws that is effective, efficient, and equitable—and that protects investor interests.

Of course, serving the interests of investors is a responsibility we share with regulators, particularly the Securities and Exchange Commission. For many years, we have sought to work cooperatively with the SEC and other agencies to acquit this responsibility.

Examples are numerous:

- Prescribing standards for personal trading by fund managers in 1994;
- Rationalizing the oversight roles of federal and state fund regulation in 1996;
- Enhancing mutual fund governance practices in 1999; and
- Recommending tough new rules for money market funds in the wake of the financial crisis.

In fact, it was ICI's groundwork in the March 2009 report of the Money Market Working Group that assured that money market funds would be the first part of the U.S. financial system to be reformed in the wake of that crisis.

We greatly respect the skill and dedication of the SEC's leadership and staff, and we understand how challenging and difficult the policymaker's role can be.

Nonetheless, there are occasions when we have fundamental differences with the SEC or other regulators.

We work especially hard, in those cases, to substantiate our views; to demonstrate how investor interests will be best served; to commend a sensible balance between the costs and benefits of regulation; and to demonstrate how regulators might best fulfill their

statutory mandates—in the SEC’s case, to promote efficiency, competition, and capital formation.

Unfortunately, in these terms, we really have our work cut out for us at this time.

Frankly, we are never happy being at loggerheads over important regulatory issues. Everything in our history and our culture as an industry and an association disposes us to work collaboratively.

But when this is not possible, when there is much at stake, you can be certain we will advocate strenuously for our understanding of what is in the best interests of the 90 million shareholders we serve. We can—and should—do no less.

Against this backdrop, I would like to discuss two prominent issues before us today:

- Funds’ use of commodity investments and the Institute’s legal challenge to the Commodity Futures Trading Commission over Rule 4.5; and
- Money market funds.

From their beginning, mutual funds have had a distinct mission—to bring the best of investment management to the investor of moderate means. The early funds promised that ordinary Americans could benefit from the skills and insights that had been available only to the wealthiest Americans.

In today’s markets, it’s difficult to meet that promise efficiently without using options, futures, swaps, and other derivatives. Funds use these tools to manage risks; to invest more efficiently; and to gain investment exposures to stocks in some foreign markets that are difficult or costly to access directly.

But some critics don’t recognize these beneficial uses of derivatives. Instead, they foster the notion that investing in derivatives is somehow “risky business” for funds used by average investors.

That attitude is helping fuel the CFTC’s unwarranted, redundant, and costly amendments to Rule 4.5.

The CFTC, of course, has jurisdiction over much of the derivatives market—including, under the Dodd-Frank Act, many swaps. But under Rule 4.5, the agency exempts many institutions from its oversight. The rule essentially says that if you sponsor a pooled investment, and you are well-regulated by another agency, such as the SEC, you don’t need a second layer of regulation from the CFTC.

Under Rule 4.5, the CFTC has excluded insurance companies, banks, and pension plans from its regulatory regime. And since 2003, the CFTC treated registered investment companies and their advisers the same way. After all—what financial product is more comprehensively regulated than mutual funds?

Now, however, the CFTC has sharply narrowed Rule 4.5—but just for funds and their advisers. The new tests are so stringent that virtually every fund adviser will need to monitor its use of derivatives on a regular basis. Some will be subject to CFTC regulation atop their current SEC oversight—a redundant, costly regime that will harm their investors. Others, to avoid this regime, may choose to reduce their use futures, options, and swaps—again, to the detriment of their investors. Either way, investors lose.

The CFTC promises to minimize the harm by “harmonizing” its rules with the SEC’s disclosure requirements. But we’ve seen the proposed rule—and we are not hearing the harmony. In any case, why would fund advisers need two different voices in their ears giving them contradictory instructions?

Additional costs for no benefit to investors—that’s not smart regulation. And the CFTC’s actions fly in the face of the agency’s legal obligations for rulemaking. After all, the CFTC made no attempt to demonstrate that SEC regulation of funds and advisers does not provide adequate investor protection.

For an industry as comprehensively regulated as ours, the CFTC amendments raise grave concerns. And so—with great reluctance—ICI has filed a legal challenge to the CFTC’s amendments of Rule 4.5. We are joined in this action by the U.S. Chamber of Commerce.

This is a highly unusual step for us—and not one taken lightly. But it answers a highly unusual provocation.

I’ve been discussing funds that use futures, options, and swaps primarily to manage risk and improve efficiency. But our investors also benefit greatly from funds that use derivatives to provide investors some exposure to a broad basket of commodities—from energy to precious metals to agricultural products. These investments offer valuable portfolio diversification, because commodities prices historically have not been strongly correlated with stock or bond returns. And as raw materials for the goods that businesses and consumers buy, commodities offer investors an opportunity to protect themselves from inflation.

Unfortunately, this use of derivatives has also come under attack—this time from political leaders who seek to blame rising oil prices on mutual fund investors. They charge that investors’ expanded use of commodity investing—through relatively new products such as commodity mutual funds—is responsible for rising and volatile prices. They attack our funds as “speculators.”

These critics are wrong on the facts—and wrong on the economics.

Careful studies by a range of academics have demonstrated that the so-called “financialization” of commodities markets is not driving price developments in individual markets. Nor is it increasing volatility.

ICI Research summarizes that work in a new paper that we’ve released today. But we’ve gone further—we’ve looked specifically at the impact of investment flows into commodity mutual funds on commodity prices.

I’m going to give away the ending—there is no impact. But let me show you the evidence.

The orange line on this chart illustrates the Dow Jones-UBS Commodities Index from 2004 through 2011. Note the elevated price levels prior to the financial crisis, the drop during the recession, and the price recovery since—just what you would expect if commodity prices are driven by economic fundamentals.

In fact, that’s what’s going on. Our paper uses statistical techniques to predict how the value of the U.S. dollar and growth in emerging markets would affect commodities prices. As you can see by the brown line, those two economic factors alone explain most of the

change in commodities prices. And this doesn't even include other fundamental factors—such as crop failures, political uncertainties in the Middle East, or inflation fears.

Our work also considers whether flows into commodity mutual funds could explain commodity prices. What's clear from this figure is that those flows don't explain much. There's scarcely any connection between flows to commodity mutual funds and prices in commodity markets. And that's not surprising—how much impact could \$48 billion in commodity mutual fund assets have on markets where trillions of dollars worth of goods and derivatives are exchanged?

Now, we don't expect facts and evidence to persuade all of the critics. There's too much political payoff in finding scapegoats for high prices of gasoline and other commodities.

Two things, however, are certain. Commodity mutual funds are not driving commodity markets. And penalizing those funds unjustly will only hurt millions of average American investors.

Investor interests also motivate and inform our activities to preserve money market funds and the great value they provide to shareholders and the economy.

We cannot envision a future in which American mutual funds are foreclosed from providing our investors tools for effective cash management through which they can access current money market returns.

For 56 million individual investors, money market funds offer the only way to achieve a current money market yield and the safety of a diversified, professionally managed portfolio. Since 1990, retail investors have earned \$242 billion more in returns from money market funds than they would have earned in competing bank products.

For millions of institutional investors who need to balance daily income and outflow, money market funds offer greater flexibility, diversification, and liquidity than either bank products or direct investments in money market instruments.

Looking beyond our investors for a moment, I'd point out that the \$2.6 trillion entrusted to money market funds is put to valuable uses throughout the economy—financing commercial paper, short-term municipal debt, asset-backed commercial paper, bank CDs, Treasury bills. In short, money market funds help keep the lifeblood of the economy flowing.

This is a remarkable success story—but not just for our industry. It is one of the great success stories of modern financial regulation. Throughout the history of money market funds, the SEC has carefully crafted rules that balance these funds' competing objectives of convenience, liquidity, and yield. Under this regulatory regime, money market funds have flourished and innovated—to the great benefit of investors and the economy.

Unfortunately, the SEC—urged on by bank regulators—seems to be on a path to deprive investors, issuers, and the economy at large of the manifold benefits of a robust money market fund sector.

On its current path, the Commission may abandon the regulatory regime under which these funds have maintained a stable \$1.00 per-share value.

Alternatively, it may force money market funds to adopt a complicated regime of capital

buffers and redemption restrictions.

In a recent survey by consultants at Treasury Strategies, four out of five institutional investors said they would reduce or eliminate their use of money market funds if those funds are subjected to a floating net asset value or redemption restrictions. Based on these investors' estimates, institutional assets in money market funds would decline by 60 percent or more.

Undoubtedly, many individual investors would react similarly. We could expect a hemorrhaging of money market fund assets.

In another study which we will release soon, ICI Research will examine the impact of requiring money market fund sponsors to provide capital buffers. This change would fundamentally alter the nature of the business. Requiring advisers to put up capital places them in a first-loss position for their funds—a risk that advisers are not being paid to assume.

It's hard to imagine fund sponsors taking on such a burden. Instead, many would prefer to leave the business, directing their skills and systems to managing similar products that are less regulated and less transparent.

The Institute is also preparing a paper on the operational challenges that funds and financial intermediaries would face in implementing the SEC's contemplated asset freezes for shareholders who redeem their money market fund shares.

We are talking about retirement plans...financial advisers...bank trust departments...insurance companies...sponsors of sweep accounts...the whole range of intermediaries that depend upon the convenience and liquidity of money market funds to provide useful and economical services to investors.

The impacts are, quite simply, mind-boggling. Thousands of intermediaries will be faced with a stark choice: invest millions of dollars in new systems to manage redemption freezes, or find a different product to meet investors' cash needs. We expect many—if not most—will opt for other products, even if those products are less regulated, less transparent, and riskier. Investors will be the losers.

The interests of our investors, the interests of the economy, and the interests of the financial system—these are powerful motivators as ICI and its members work to preserve the fundamental nature of money market funds.

How can we do that?

Through research, we and our members are demonstrating the flaws in the SEC's contemplated changes.

We are standing up for the success of the SEC's prior amendments to money market fund regulation. In January 2010, with the fund industry's strong support, the SEC adopted rule amendments that raised the credit quality, shortened the maturity, enhanced the transparency, and increased the liquidity of money market fund portfolios.

These reforms were tested in the troubled markets of the last year—and they passed with flying colors. Thanks to the 2010 amendments, money market funds are stronger today—and today's money market fund is a very different product from its 2008

predecessor.

It's ironic, but we seem more cognizant of what was accomplished than are the regulators themselves. The SEC should be proud that it achieved so much, so quickly, to strengthen money market funds—without undermining their core principles or their role for investors and the economy.

Money market funds are also an example of how fund regulation has gone global.

Two powerful trends are at work in the international financial system. One trend is the rise worldwide of regulated funds as major financial intermediaries. Sponsors and managers of these funds for the past two decades have been vigorously expanding their international reach.

The second trend is an inevitable consequence of the first: regulators and other policymakers have begun to focus more intently on funds and fund management than ever before. Regulated funds, their advisers, and their investors face a formidable array of regulatory and policy challenges.

Recognizing these trends, the Institute last year launched ICI Global—an organization that will advance the interests of regulated funds, their managers, and their investors on a global basis, and not simply from the perspective of a discrete jurisdiction or market. It is unique in that no other organization responds to the reality that today's fund managers face a range of issues, vitally important to their business, that are global in nature and demand a global response.

Seven months after its founding, ICI Global is deeply engaged in a host of issues: the Volcker Rule; trading and market structure; financial transaction taxes; the Foreign Account Tax Compliance Act, or FATCA; and others. Tomorrow morning, ICI Global Managing Director Dan Waters will lead a distinguished panel in exploring management priorities in a challenging global financial environment.

We're excited about the potential for this new organization—and we invite global funds to join with us in reaching that potential.

ICI's responses to the CFTC's Rule 4.5 and our advocacy on the SEC's concepts for money market fund regulation have many people asking whether the Institute is fundamentally changing its approach to regulation.

My answer to that is a flat, emphatic no.

Our core principles and mission remain the same. We are advocates for funds, their shareholders, directors, and investment advisers. We must act as we see those interests.

With great reluctance, we must challenge the CFTC's attempt to impose unwarranted, redundant, and costly regulation on our funds and investors.

We must speak up for funds' ability to use commodity derivative investments to the benefit of their shareholders.

We must defend money market funds and the value they bring to investors, issuers, and the economy.

On all these issues, it is important to note that ICI may propose—but the regulators will dispose. We are not determining the course of regulation.

Instead, it is our role to ensure that the regulators are fully informed; that they are equipped with information to help them fulfill their statutory mandates; and that they have a clear understanding of the far-reaching and, in these cases, negative impacts of their ideas.

As Mellody noted, ours is an optimistic industry. We wouldn't have 90 million investors placing their trust in our funds if we didn't offer the vision of a better future. And we wouldn't deserve that trust if we didn't devote our energies ceaselessly and tirelessly to providing the skills, the services, and the advocacy on vital public policy issues that our investors need.

I'm confident that, working together, we all will continue to earn that trust. Thank you.

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