SPEECH

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2001 General Membership Meeting: President's Report

ICI President's Report at the 2001 ICI General Membership Meeting

by
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Good morning. Thank you, Mitch, for your generous introduction, and for developing such a terrific program as Chairman of this year's General Membership Meeting.

And special thanks to the Institute's Chairman, Terry Glenn. Terry is a great industry leader, with a remarkable combination of experience and vision. We are extremely fortunate to have him as our navigator.

Like you, Terry and I have been privileged to participate in this industry's phenomenal success. Mutual funds have democratized our markets by helping millions of Americans save and invest for their long-term goals. Mutual funds have fueled job growth and contributed to a more productive and competitive economy. And mutual funds have been recognized by leaders in Washington and around the world as well managed and effectively regulated.

As Terry reminded us, however, confidence in mutual funds has never been preordained. We must earn our reputation anew each day.

No one can foresee all of the challenges and opportunities that lie ahead. But I am certain about one thing. If we assume that our current strong position guarantees our future success, we will surely decline. Oliver Wendell Holmes, Sr. recognized this more than one hundred years ago. He observed that the great thing in this world is not so much where we stand, as in what direction we are moving. [W]e must sail, and not drift, nor lie at anchor.

Our industry has succeeded because we have repeatedly "moved in the right direction" for investors.

Thirty years ago, when Terry and I were starting out, almost all mutual funds were equity funds, usually sold by stockbrokers with full 8.5 percent sales loads.

Today, our products, our services, and our distribution channels include choices that were unimaginable just 30 years ago.

This morning I will discuss three areas where we must move in the right direction for investors. These areas are:

- the laws that protect fund shareholders;
- the standards we set for ourselves; and
- the responsibilities that come with our prominence.

First, we must never assume that yesterday’s laws and regulations are good enough for today’s shareholders.

That is why we strongly support the SEC’s ongoing effort to improve the quality of information disclosed to mutual fund shareholders. As you know, over the years disclosure requirements for mutual funds piled up. Eventually it became apparent that the SEC’s "disclose everything" approach was overwhelming, rather than informing, fund investors.

In 1998, with strong industry support, the SEC enacted sweeping reforms of our core disclosure document, the mutual fund prospectus. A major goal of disclosure reform was to eliminate prospectus clutter that obscures other information helpful to investors when making a decision about an investment in a fund.

As a result of this effort, fund prospectuses were transformed from kitchen-sink repositories of voluminous information to plain-English documents that investors can actually use and understand.

The SEC is now reviewing mutual fund shareholder reports. The goal is to refocus these reports on matters most essential to informed investment decisions. We strongly support the SEC’s approach, and its practical focus on producing reports that are more useful for fund shareholders.

Other groups, however, want mutual funds to report more information more frequently, particularly a fund’s complete list of current portfolio holdings. We have yet to see evidence that those who invest in mutual funds want more encyclopedic disclosure. But we have seen considerable evidence that those who trade against mutual funds would welcome it.

Arbitrageurs, day traders, and market timers already exploit current mutual fund disclosures. Last year, a former hedge fund operator called a mutual fund’s annual report "the greatest bargain" in investment research.

He admired this mutual fund’s portfolio managers, and said its semiannual list of holdings allows traders to "make money from their insights." An article on a well-known investor website was even more blunt: "Fund managers spend lots of time determining the best stocks to pick. Why not take a free piggyback ride off those folks who are paying fees?"

Providing professional traders and other opportunists with more information about a fund’s holdings would increase their ability to siphon off a fund’s earnings. Efforts to front-run mutual fund trades and free ride on fund investment strategies would inevitably increase.

We understand that those calling for more disclosure do not intend to harm mutual fund investors. However, it is clear that mandating more portfolio disclosure would make money for traders—money that will come straight out of the pockets of fund shareholders.

Moving in the right direction for shareholders means providing clear, concise, and meaningful information that will help them make informed investment decisions. The SEC led the way when it revised fund prospectuses. We are hopeful it will do so again with shareholder reports.

The SEC has also suggested that shareholder reports include concise descriptions of other key information, such as the level of fees paid by shareholders during the past year. We believe that shareholder reports are the appropriate place to include such information, which could assist shareholders as they evaluate their current mutual fund investments.

In working for a strong regulatory system that effectively serves investors, we must remember that mutual funds do not exist in isolation. We are part of a broad and growing spectrum of investment management products and services. We have long supported the innovations that make this spectrum of products and services possible. And we welcome the vigorous competition it produces. But "moving in the right direction for investors" requires us to act whenever functionally similar products or services threaten investor interests.

Some have asked why this should concern the mutual fund industry. The answer is clear. We act because the foundation of our success is shareholder trust and confidence. Products that mimic mutual funds but avoid critical investor protections are creating serious and unnecessary risks to this foundation. If parallel industries are permitted to develop, one regulated, one unregulated, the only direction we are destined to move in is a "race to the bottom," as competitive forces pressure all firms to minimize regulatory costs.

We have been required to call attention to this issue on many different occasions in the past. We've argued successfully that publicly offered variable annuities and bank common trust funds should be seen as mutual funds We've repeatedly made the point that if hedge funds want to enjoy the privilege of publicly offering their shares, they must be subject to corresponding regulatory responsibilities. Syd Mendelsohn, a former Director of the SEC Division of Investment Management, expressed the relevant policy issue more concisely. According to Syd, "If it walks like a duck, and quacks like a duck, it's a duck."

As many of you are aware, the Institute recently suggested that the SEC review whether relatively new portfolio investment programs are investment companies within the meaning of the Investment Company Act. These programs include offerings that consist of carefully selected and professionally managed investment portfolios. The structure of these synthetic fund-like products pose many of the precise risks that the 1940 Act was designed to prevent—self-dealing; excessive fee arrangements; deviation from stated investment objectives; and abuses in disclosure and advertising. SEC rulemaking in this area is critical.

Of course, effective regulation that serves investors necessarily requires effective regulators. We have been fortunate that the SEC's integrity and professionalism have helped it attract an excellent staff. But to sustain its effectiveness, the SEC also needs to retain its excellent staff. To do so, the Commission must be able to provide more competitive compensation. The Institute has renewed its call for congressional action to meet this need.

Strong and respected regulations will help us "move in the right direction" for shareholders. But law and regulation have inherent limits.

Mutual funds must constantly examine issues that go beyond legal requirements, my second topic this morning. The well-being of our shareholders depends on the voluntary standards that we choose to live by.

Our commitment to high voluntary standards was evident in the recommendations of the Institute's Advisory Group on Best Practices for Fund Directors. The system of independent oversight that governs mutual funds is at the heart of our regulatory system and our strong fiduciary culture. I know of no other companies in the world that are required by law to have the level of independent oversight required of U.S. mutual funds.

Even so, our industry adopted governance standards that go far beyond the law. The Council of Institutional Investors, a forceful advocate for corporate governance reforms, applauded the recommendations: "The ICI recommendations are … far-reaching, extending beyond current legal requirements. [Some are] leading edge, surpassing practices currently endorsed by the Council."

We were gratified that the SEC also recognized the significance of our recommended best practices. However, we are concerned that certain aspects of the Commission's recent rulemaking in this area could significantly and unnecessarily complicate the governance system's goal of protecting fund shareholders. We will continue to bring these concerns to the SEC's attention.

Another mutual fund voluntary practice that continues to grow in importance is investor education. Long-term investing requires an appreciation of markets and an understanding of investment fundamentals. In light of these needs, promoting investor education remains one of our most enduring priorities.

The rewards of investor education are tremendous. Earlier, Terry Glenn, in his address, noted the positive and far-sighted response of mutual fund investors to the recent bear market in stocks. No mass redemptions. No evidence of panic.

I believe our investors have been calm and rational because our industry has worked so hard to reinforce sound investment principles. Fund companies provide a remarkable array of educational services, newsletters, and online programs and tutorials to shareholders and prospective investors alike. And I'm proud to report that we've never stopped there. We have encouraged and supported SEC initiatives to improve investor awareness through reform of prospectuses, shareholder reports, advertisements, sales literature and education programs. The fruits of these efforts have been visible in the challenging months that have just passed.

The Institute has also intensified investor outreach efforts. We've prepared easy-to-use brochures, videos, and interactive tools on the importance of a long-term perspective, containing expectations, the impact of fees, and the oversight role of fund directors.

Most recently, we've developed a program to ensure that we are "moving in the right direction" for all potential investors. The Institute's Education Foundation has joined with the National Urban League—and this year with Coalition of Black Investors-Investment Education Fund—to sponsor the "Investing for Success" program. Since its launch one year ago, Investing for Success workshops have been or will be held in various cities around the country.

We are proud of this innovative program. It's goal is particularly important: to help middle-income African Americans become more aware of opportunities to invest for education and retirement. Mutual funds have been a great American success story, transforming lives and families, opening doors and possibilities. We must redouble our efforts so that these opportunities and possibilities are known to everyone.

Finally, the new responsibilities that flow from our prominence, my last topic this morning.

Our industry's prominence obliges us to address important issues beyond traditional mutual fund regulation and operations. "Moving in the right direction for shareholders" means that our voice must be heard on national policy debates that affect their interests.

Nowhere is this responsibility more evident than in the public policies that affect long-term savings and investment. We must support policies that help individuals better prepare for major life events such as retirement and education. I'd like to briefly highlight four specific ways that we are doing this.

First, self-directed retirement plans like the 401(k) require that employees make important investment decisions. Legislation has been proposed that would allow those who provide the plan's investment options to offer advice to employees. The need and desire for such advice is acute, and we support enactment of this legislation.

Second, the mutual fund industry continues to view the bipartisan pension reforms sponsored by Representatives Portman and Cardin and Senators Grassley and Baucus as our top legislative priority. This legislation enjoys overwhelming support, and would benefit tens of millions of working Americans, now and for many years to come.

Third, years of escalating college costs have caused millions of parents to fear that they will be unable to support their children's higher education. Eighty-five percent of parents with children under 18 hope to send them to college.

That represents 28 million family households. Most of these households have more than one child, yet 40 percent of them have yet to save anything for college. Ten percent have saved $1000 or less.

Unfortunately, the cost of a college education could double in the next 20 years, making the savings gap even worse. We must find ways to help keep college education within reach. That's why the Institute supports measures to increase education savings, such as proposals to enhance state-sponsored 529 plans and education IRAs.

Fourth, as growing numbers of Americans embrace investing as part long-term household savings, a reexamination of the taxation of capital gains is warranted. Many proposals have been made, including reduced rates and annual exclusions. Congressman Saxton has added to this mix by proposing that a fixed annual amount of mutual fund distributions be eligible for deferral if reinvested. "Moving in the right direction for shareholders" requires us to work for commonsense improvement in our tax system that will help mutual fund shareholders meet long-term savings and investment goals.

Finally, an important industry responsibility is to make sure that the ongoing debate about the optimal structure of our trading markets serves fund shareholders. Mutual funds are the means by which middle America participates in the equity markets. We must do all that we can to enhance transparency and liquidity in our markets, and to make Congress' goal of a fair and efficient national market system a reality.

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Let me close by noting that many observers were busy this past year making confident pronouncements about our industry's future—some predicting imminent decline, others forecasting continued healthy growth.

Contrary to the prognosticators, neither fate is preordained.

Our future will be determined by what we do. We must not stand pat. We must not "lie at anchor."

Instead, we must continue to "move in the right direction for investors"—by supporting strong pro-investor regulation, by adopting voluntary standards that go beyond law and regulation, and by embracing new responsibilities.

To "move in the right direction," our actions must be guided by a single beacon—an unshakeable commitment to serving the best interests of mutual fund shareholders.

William O. Douglas, the late Supreme Court Justice and SEC Chairman, once observed, "Service to stockholders cannot be a passive thing ... It calls for constant diligence and devotion to the standards of fiduciary responsibility."

Our crowning achievement is that we have always understood and acted upon this basic truth. Constant diligence and devotion to the best interests of fund shareholders has been the guide to our past success. It must be our beacon in the future.

Thank you.