The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

TESTIMONY

August 10, 2009

IDC Offers Views on Administration's Financial Regulatory Reform Proposal

Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals

Hearing before the
Committee on Financial Services
United States House of Representatives

Statement of the
Independent Directors Council

July 17, 2009

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Introduction

The Independent Directors Council (IDC)1 commends the Committee for the significant time and attention it is devoting to considering how best to achieve successful financial regulatory reform. As the Committee holds hearings to gain a better understanding of all interested parties' perspectives on the Obama Administration's financial regulatory reform proposals, IDC wishes to offer its perspective on this very important matter. Mutual funds, exchange-traded funds, and other registered investment companies (collectively, "funds") are a significant component of the financial markets. Fund independent directors, who oversee the management and operations of funds on behalf of over 93 million shareholders, have a unique perspective on the fund regulatory framework and the benefits it provides fund investors. This framework, which has been in place for almost 70 years, has worked remarkably well, providing fund shareholders a high level of protection and oversight that is unparalleled in the financial services industry.

The Administration's proposals, reflected in the Department of Treasury's white paper and the draft legislation for the Investor Protection Act of 2009, suggest reforms in a number of significant areas. IDC addresses three specific aspects of the proposals below.

I. Consumer Financial Protection Agency

The Administration's proposal for a new Consumer Financial Protection Agency excludes funds and their advisers from the CFPA's jurisdiction, and IDC strongly supports that approach. The Administration's white paper expressly states that the CFPA would not have jurisdiction over "investment products and services already regulated by the SEC and [CFTC]," and the draft legislation contains explicit exclusions for any fund, investment adviser, or broker-dealer required to be registered with the SEC. The SEC's comprehensive regulatory framework governing funds and its focus on protecting investors and maintaining the integrity of the markets has proven over time to work extremely well. It has contemporaneously safeguarded investor interests while allowing for the growth of a competitive and innovative fund industry.

In addition to funds and their advisers, IDC believes that the SEC should continue to have authority with respect to all fund service providers that are currently regulated by the SEC. IDC notes that the draft legislation does not clearly exclude these service providers from the CFPA's jurisdiction and urges the Committee to ensure that any legislation does so. Funds are dependent upon a number of service providers, not just investment advisers, to operate. Other service providers that are integral to a fund's operations include, for example, transfer agents and clearing agencies. Extending the exclusion to cover these entities is necessary given the unique characteristics of the structure and operations of funds that would make it difficult as a practical matter to separate fund regulation from all other aspects of their oversight performed by the SEC. Failure to extend the exclusion likely would result in overlapping and possibly conflicting regulation in connection with fund service providers and their activities. IDC therefore believes that Congress should more clearly delineate the lines of jurisdiction for the CFPA and should include an explicit exclusion in the legislation for any SEC-regulated entity acting in its regulated capacity.

II. The Investor Protection Act of 2009

The Administration has separately drafted legislation, The Investor Protection Act of 2009, which presents two issues of concern to IDC: first, it authorizes the SEC to require that only fund disclosure be provided to investors at or before the point of sale; and, second, it fails to impose a clear fiduciary duty standard on broker-dealers who provide investment advice. IDC's concerns are discussed below.

a. Point of Sale Disclosure

The Act would authorize the SEC to require delivery of fund disclosure at or before the point of sale. This provision would apply only to funds. As IDC has previously maintained, any disclosure obligations for financial products at the point of sale should apply equally to all retail investment products, not just funds.2 IDC firmly believes that point of sale disclosure requirements would benefit all investors, not just fund investors. It is undeniable that the policy goals underlying point of sale disclosure—assuring that investors understand their investment and the compensation arrangements of those recommending the investment—are no less important for other types of investments. Point of sale disclosure requirements applicable to the sale of funds, but not other investments, such as separately managed accounts, could disadvantage many investors, particularly middle-income

Americans, inasmuch as it likely will discourage the sale of funds. Consequently, investors could be steered into products that are significantly less regulated than mutual funds and, thus, do not offer comparable protections (e.g., oversight by boards of directors, diversification requirements, strict leverage restrictions, and daily pricing with mark-to-market valuations).

b. Investment Adviser and Broker-Dealer Regulation

IDC supports the imposition of a fiduciary duty on broker-dealers who provide investment advice about securities, just as investment advisers are held to a fiduciary duty standard for the same conduct. While it appears that the draft legislation attempts to impose a fiduciary duty on any broker, dealer, or investment adviser who provides investment advice, it fails to do so.3 Rather, the text of the proposed legislation would impose a standard of conduct that seems to embody substantially similar qualities as a fiduciary duty without specifically using the term, “fiduciary duty.” IDC urges Congress to clarify this language and clearly state in the legislation that the standard of conduct being prescribed is in fact a fiduciary duty.

We recognize the challenging and formidable task before the Committee and appreciate your consideration of our views as the Committee moves forward in developing legislation to reform the financial services regulatory regime.

endnotes

1 The Independent Directors Council serves the fund independent director community and provides a venue to advance the education, communication, and policy positions of fund independent directors. IDC’s activities are led by a Governing Council of independent directors of Investment Company Institute (ICI) member firms. ICI members manage total assets of $10.5 trillion and serve over 93 million shareholders, and there are over 2,000 independent directors of ICI member funds. The views expressed by IDC in this statement do not purport to reflect the views of all fund independent directors.

2 See IDC Letter to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission (July 19, 2007) (recommending that the SEC make any point of sale disclosure requirements applicable to all investments that brokers and other financial intermediaries sell), available on the SEC’s website at http://www.sec.gov/comments/4-538/4538-277.pdf.

3 The title of Section 913 uses the term, “fiduciary duty,” but the text of Section 913(b) does not. In addition, the Administration’s fact sheet on its legislative proposals, available at http://www.treas.gov/press/releases/tg205.htm, states that the “Administration's legislation would give the SEC authority to require a fiduciary duty for any broker, dealer, or investment adviser who gives investment advice about securities.”