SPEECH

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National Investment Company Service Association Conference: Remarks

Remarks at National Investment Company Service Association Conference

By Dan Crowley
Chief Government Affairs Officer, Investment Company Institute

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Good morning. My name is Dan Crowley. As many of you know, the Investment Company Institute represents the mutual fund industry, more than 8,500 mutual funds and 90 million shareholders with some $8.7 trillion in assets. The mutual fund members of the ICI represent 98 percent of all assets of U.S. mutual funds. The relevance of these figures will hopefully become obvious as I lay out the Institute's legislative agenda.

As Chief Government Affairs Officer, I head a team of professionals dedicated to representing the interests of mutual funds, their advisors and shareholders before Congress and the Executive Branch of the federal government. I want to emphasize at the outset that these remarks represent my personal views and are not intended as an expression of official Institute policy. Instead, my goal today is to speak to you more generally about some of the current developments on Capitol Hill and what we hope to achieve for the benefit of mutual fund investors.

The Public Policy Environment in Washington

Congress will reconvene at the end of this month for the start of the 2nd session of the 109th Congress. In a nutshell, we expect the legislative agenda this year to primarily be a continuation of the issues considered last year. That is to say that following the 2004 election, in which Republicans maintained the Presidency and the Majority in both houses of Congress, there was extensive discussion about the need to incentivize long-term savings and to enhance the retirement security of millions of Americans. We are basically midway through that discussion.

As you will undoubtedly remember, last year President Bush exercised what I believe to be considerable leadership in calling for reform of the social security system, previously deemed to be the "third rail" of American politics – touch it and you die.

The President recognized that the current economics of the social security system are such that its long-term solvency is unsustainable – and he expended a significant amount of political capital at some risk in calling for reform. He also emphasized that private sector solutions are needed to address the long-term solvency of social security. In that context, the Institute recognized that mutual funds are a critical part – indeed the foundation - of retirement security. Not because they might be suitable vehicles for social security assets, but rather because of their supporting role with respect to the other two legs of the retirement security stool – employer provided retirement accounts, such as 401(k)s, 403(b)s, etc., and individual retirement accounts, particularly the IRA.

In my view, mutual funds are simply the most effective way for most Americans to receive low cost portfolio diversification and professional portfolio management. In fact, mutual funds have democratized investing in the United States and have helped create a culture of investing here that is unparalleled in the rest of the world. We as an industry therefore have a responsibility to ensure the safety and integrity of our products, and to be ever mindful of our fiduciary role as the custodians of these assets. Frankly, that role was questioned in the wake of the trading scandals. However, by consistently demonstrating that our immediate, instinctive reaction in the face of such challenges is to always ask "what is the right thing for investors?" we have managed to retain their confidence. Some may question, for example, whether the Institute's position on such issues as the hard 4:00 pm close or mandatory redemption fees were optimal from the standpoint of mutual fund advisors, brokers or other intermediaries – but no one can credibly question whether those positions were consistent with investor interests.

At the beginning of each new Congress, the Institute's government affairs team asks a very simple question – "What public policy changes would be consistent with the interests of mutual fund investors, as well as fund managers, and what can we do to achieve them?"

The Institute's Current Policy Agenda

At the start of this Congress, given the national focus on retirement security issues, we decided to advance the following policies:

- Defer taxation of automatically reinvested capital gains: In short, we want to strengthen the ability of mutual fund investors to save for retirement by deferring taxation of automatically reinvested capital gains. I will elaborate about the GROWTH Act in a moment.
- Modernize the rules regarding who may offer investment advice to workers in a 401(k) plan: That is, make it easier for 401(k) investors to turn to the professionals most familiar with their 401(k) plan investment options for advice. It is abundantly clear that investors need and are seeking more advice in these plans, yet the investment providers – the fund companies – are prohibited from recommending specific options due to concerns about potential conflicts of interest.
- Make permanent the retirement, education and other savings incentives enacted in the 2001 EGTRRA tax package: These provisions increased IRA and 401(k) savings limits, created 529 plan options, authorized "catch up contributions" from older savers, and more. They are now scheduled to expire in 2010. If they do, IRA contributions will drop from approximately $5,500 a year back to $2,000. For a person aged 50 or older, the limit on 401(k) contributions could drop from around $22,000 in 2010 back to $16,000 thereafter.
- Make permanent the reduced tax rates on capital gains and dividends enacted in the 2003 JGTRRA tax package: These provisions are now scheduled to expire in 2008.

- Encourage greater participation in employer retirement plans by encouraging that workers be automatically enrolled unless they opt out: Currently, 20 percent of those eligible to participate in 401(k) plans fail to do so. ICI research has shown that making participation automatic unless workers opt out will significantly increase participation, particularly among lower-income workers. Greater participation translates to potentially greater savings, which can improve the retirement preparedness of these Americans.
- Permit greater retention of retirement savings by delaying the date at which IRA savers must begin taking withdrawals: Currently, distributions must begin at age 70 and a half, yet people now expect to live longer in retirement and must be careful about how quickly they deplete their precious retirement assets so that they do not experience their worst fear – outliving their money.
- Encourage the creation of new and more universal tax-advantaged savings opportunities.

Some of these tax incentives will necessarily involve reductions in federal tax revenues, at least in the short-term, which means that they are in competition with other pressures on the federal budget such as the deficit, the continuing war in Iraq, and most recently the colossal damage caused by hurricanes Katrina and Rita. Despite that tension, I am very pleased to report that we are making real progress on a number of these issues, as I will describe in a moment.

The GROWTH Act

To begin with, the bipartisan "Generating Retirement Ownership Through Long-Term Holding" (GROWTH) Act, (H.R. 2121 and S. 1740), introduced in the House in May by Rep. Paul Ryan (R-WI) and Rep. William Jefferson (D-LA) and in the Senate in September by Sen. Mike Crapo (R-ID) and Sen. Tim Johnson (D-SD) would be a valuable contributor to retirement savings efforts.

The GROWTH Act, which currently has 60 bipartisan cosponsors in the House, and six bipartisan sponsors in the Senate, would keep more retirement savings invested and growing longer by deferring taxation of automatically reinvested capital gains until fund shares are sold, rather than allowing those long-term gains – which generate no current income or cash in hand – to be taxed every year. The fact that this proposal has attracted 66 bipartisan, bicameral Congressional sponsors in just seven months is a testament to the wisdom and popularity of such a change.

Many of today's workers do not yet have in place the retirement savings supplement to Social Security that is needed for a secure retirement. In fact, almost half of American workers – nearly 71 million of 151 million workers – are not offered any form of pension or retirement savings plan at work.

Meanwhile, the number of years spent in retirement is growing. So too are the costs individuals can expect to bear in retirement. For example, the Employee Benefit Research Institute estimates that an individual retiring at age 65 in 2014 will need $285,000 just to cover health coverage premiums and expenses.

Mutual funds are a hugely important part of American workers' preparation for retirement, both through their employers' retirement plans and on their own. Mutual funds now make up half of the $3.2 trillion held by American workers through 401(k) plans and other similar job-based savings programs. More than 30 million American households are saving through taxable mutual fund accounts, either as supplements to their employers' plans or because they do not have such plans.

Mutual fund investors who automatically reinvest are doing the right thing. They are saving for the long term, contributing to our national economy, and building up their own retirement nest eggs. These Americans should be encouraged to save – not punished for doing so through a tax on automatic reinvestments.

Millions of Americans would benefit from the GROWTH Act – those mutual fund investors now saving on their own for retirement without access to an employer-sponsored plan, those now supplementing their employer's plan because they know that plan won't provide enough savings, and the millions of working Americans who have no access to an employer-sponsored plan and haven't yet begun to save on their own.

In summary, Americans need to do more to prepare for their retirement and the GROWTH Act provides middle income Americans a better tool to grow their long-term retirement savings.

Lifetime Payment Accounts

Congress is also exploring the use of tax incentives to encourage baby-boomers on the verge of retirement to "annuitize" their retirement income. In pursuing the laudable policy goal of making retirement savings last a lifetime, Congress should recognize and include the varied alternatives of financial services and products that fulfill this purpose, including "Lifetime Payment Accounts." In short, given the grave challenges in meeting retirees' lifetime income needs, no one solution can be expected to be a panacea, and therefore Congress should encourage the use of all products that can perform a useful role.

Lifetime Payment Accounts ("LPAs"), for example, are systematic withdrawal programs that provide periodic distributions from mutual fund accounts over the investor's life. For many people entering retirement, this will be the simple, flexible and affordable path that is best suited to their needs and those of their families. Significantly, LPAs allow retired investors to keep their money at work in the market and to benefit from gains, particularly in equities, to help offset inflationary risks. Any new distribution assistance incentives should recognize and encourage this option, too – otherwise, many of the retirement savers in need of this help may find themselves left out.

Recent Progress

Let me turn briefly to some specific pieces of legislation currently working their way through the House and Senate that include some of the provisions I described earlier. In fact, two major legislative proposals are advancing that include several provisions of interest to us. Specifically, tax reconciliation and pension reform measures are at the top of the current legislative agenda.

As part of the "budget reconciliation" process, the House and Senate are considering spending reduction bills, as well as tax cut bills. The House and Senate have each passed their versions of the spending cuts bills (H.R. 4241 and S. 1932). I note that both of these bills include proposals to increase premiums paid to the PBGC in the event that pension reform legislation is not enacted. With respect to tax cuts, the Senate passed its version (S. 2020), on November 18, which included AMT relief and extension of the "saver's credit" for lower-income workers that was enacted in 2001. That provision will expire this year, and the bill would extend it to 2009. The House version of the tax reconciliation bill (H.R. 4297), which passed the House on December 8, would extend the savers credit to 2008.

Most significantly from the mutual fund industry's perspective, the House bill includes a 2-year extension of the 15 percent tax rate on capital gains and dividends, from 2008 to 2010. While the Senate bill did not include such a provision, we remain optimistic that the conference committee that will be convened to reconcile the differences between the House and Senate bills will include such extension of JGTRRA in its conference report. One of the reasons for our optimism is House passage in December of a separate AMT relief bill, which should avoid the need to deal with the AMT as part of the tax reconciliation process. I won't bore you with the esoteric details of Senate parliamentary procedures, but it should suffice to say that AMT relief is likely to be sufficiently popular to pass the Senate without needing to rely on the reconciliation process, which requires only a simple majority.

Finally, with respect to pension reform legislation, the Senate passed its version, (S. 1783) on November 16 by a vote of 97 to 2. That bill includes an automatic enrollment provision and directs the Department of Labor to issue regulations giving fiduciary protections for "default" investment options. It also permits state and local governments to maintain 401(k) plans. In the House, the Ways & Means Committee and the Education & the Workforce Committee passed their versions of pension reform legislation, which was approved by the House on December 8. The Ways & Means Committee added a number of defined contribution provisions we favor, including an automatic enrollment provision, and makes the IRA, 401(k) plan, etc., provisions in EGTRRA permanent. It also allows that up to $500 of unused healthcare Flexible Spending Account money may be either carried over into the next year or contributed to a Health Savings Account. We had been hopeful that the House would consider the pension bill before adjourning for the year, but it now appears likely that House consideration will be deferred until next year, although that remains to be seen.

There are a number of other provisions in these bills that will impact the mutual fund industry, particularly those relating to hurricane relief, charitable contributions, and the like. Of course, the ICI government affairs and legal teams are monitoring all of these developments and will keep members apprised as they are enacted.

As you can see, the Institute is playing a vitally important role and has proactively advocated a number of sound public policy proposals to benefit investors. These proposals are currently being debated in Congress. We are optimistic that several of them will be enacted this year, and that mutual fund shareholders will be the beneficiaries.

Thank you again for this opportunity to speak to you about the Institute's legislative program. I would be happy to answer any questions.