

SPEECH

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1997 General Membership Meeting: President's Report

ICI President's Report at the 1997 General Membership Meeting

by
Matthew P. Fink
President, Investment Company Institute

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Good morning.

Like Don Powell, I am amazed at the size of today's audience. I can recall a far different situation twenty-three years ago. That year's General Membership Meeting was held at another hotel, just a few blocks from here. After the last session on the first day, the attendees were waiting for the reception to begin in two hours or so. In those days, my wife and I lived in the area, so we invited everyone over to our apartment. We picked up soda and beer on the way home. We had a great time entertaining about half of the attendees at GMM in our two bedroom apartment.

The theme of this year's annual meeting, "Continuing a Tradition of Integrity," calls to mind the unique culture of the mutual fund industry -- a commitment to investor education; advocacy of savings incentives for middle America; support for strong government regulation under a single national regulator; and adherence to high voluntary standards.

These traditions are fundamental. They are based on the absolute necessity of maintaining the confidence of our shareholders.

I am convinced that these traditions have been critical to our past success. I am equally convinced that our future will depend upon our ability to continue and strengthen these traditions in the face of new circumstances.

The mutual fund industry is now at the forefront of U.S. financial services. In 1980, about 4.6 million households owned mutual funds, and industry assets totaled \$134.8 billion. Today, 36.8 million households, or about 63 million individuals, own mutual funds, and assets are nearly \$3.7 trillion, second only to commercial banks. About one-fifth of United States retirement assets are entrusted to mutual funds.

Never before has our industry been subject to more scrutiny -- appropriate scrutiny -- from Congress, the SEC, the media, and the public at large.

The steadfastness of our investors in years to come will depend, in large measure, on their understanding of markets and investing, and their confidence in the integrity of the mutual fund industry. Today, I would like to share my thoughts on what we must do to maintain the confidence of our shareholders.

First, investor education.

A commitment to educating consumers is perhaps our industry's most long-standing tradition. In 1929, Paul Cabot, one of the founding fathers of our industry, declared that "the remedies for possible abuses are publicity and education." We have followed Cabot's advice for the past fifty-seven years, and the rewards, for our shareholders and our industry, have been tremendous.

A number of self-proclaimed experts have been predicting that, at the first significant downturn in the markets, there will be massive redemptions by fund shareholders, redemptions that will in turn produce even greater market declines.

As Don Powell mentioned, last spring the Institute completed a comprehensive [study of shareholder behavior](#) over the last 50 years. Our study found no evidence of shareholder runs during fourteen market setbacks. Our study did not find that shareholders are insensitive to market declines, but that their response is measured and gradual.

Recent events support these conclusions. From its March 11 high, the stock market lost nearly ten percent of its value by April 14 before rallying. While not a major correction, this drop was somewhat of a test. Again, there was no shareholder panic. There were no mass redemptions. Investors reacted calmly and rationally.

A major reason for this steadfastness is investor education. Educated investors take a long-term view of investing, understand potential risks and rewards, and do not panic. I have no doubt that, in the future, there will be difficult markets and adverse events. Therefore, we must do all that we can now to educate our shareholders as to the risks, as well as the rewards, of investing.

Over the years, our industry has worked with the SEC to improve fund prospectuses, advertisements, and sales literature. As a result, we offer the best disclosure in financial services, and we support the SEC's efforts to make it even better.

But we have realized that laws and regulations aren't enough. Therefore, individual fund organizations have stepped up their voluntary educational efforts, through presidents' letters, shareholder reports, and newsletters. An enormous amount of useful information is communicated to fund shareholders in this manner.

The Institute has intensified its own efforts. We've published consumer brochures on matters as diverse as how to read a fund prospectus, the benefits of dollar cost averaging, and IRAs. We've produced video news releases on the importance of long-term investing, the impact of interest rate changes on bond funds, and money market funds' lack of FDIC and SIPC insurance.

Today, we are launching the ICI Mutual Fund Connection, our public-access website. We're also releasing a new series of brochures to help investors better understand all types of

investment companies. More is planned.

We're working on an educational video on the basics of mutual fund investing, as well as a series of video news releases emphasizing investor education. We're also expanding our TV and radio tours, featuring industry leaders who will focus on improving shareholders' understanding of key investment issues.

It is extraordinary that an industry has committed so much of its resources to educating the public about the risks, as well as the rewards, of its services. But it is the right thing to do. And I am convinced that our industry's tradition of investor education has been critical in producing widespread public confidence in our industry.

Hand in hand with investor education is a second tradition -- our advocacy of national policies that enable ordinary Americans to realize their investment goals.

For most Americans, financial security, whether it means paying for a child's college education or building a nest egg for retirement, will only be realized through effective personal savings and investing. That's why the mutual fund industry has always supported legislative changes that provide incentives to ordinary Americans to invest for their futures.

In 1962, our industry supported Keogh plans. We were at the forefront in the battles for IRAs in 1974, and for universal IRAs in 1981. Last year, we worked for [legislation](#) that expanded the spousal IRA, and established SIMPLE plans for small businesses, and 401(k) plans for tax-exempt organizations.

Today, the mutual fund industry continues to lead the fight for expanded availability of IRAs. We support measures to improve pension portability, to expand retirement plan coverage, and to make employer plans easier to administer and to understand.

Many of these initiatives are part of a trend away from defined benefit pension plans, where the employer selects investments, to defined contribution plans, where each worker directs his or her own investments.

Some assert that workers generally are better off under defined benefit plans, which, in theory, guarantee a specific level of benefits with little risk. However, research conducted by Dartmouth Professors Samwick and Skinner demonstrates that defined contribution plans generally are better, and less risky, for most workers. The study notes that retirement income from a defined benefit plan typically is heavily dependent on earnings in the last three to five years before retirement. Therefore, job changes can cause workers to forgo some or most of their benefits. Earnings fluctuations raise other risks. The study finds, in contrast, that steady annual contributions to defined contribution plans reduce risk by smoothing out fluctuations in earnings and investment returns. The professors conclude that:

"defined contribution plans with reasonable rates of return and modest contribution rates yield both a higher median income, and considerably less risk, than a typical defined benefit plan."

This research demonstrates that defined contribution plans deserve a prominent role in our retirement system. We must continue to do all that we can to support improvements in these and other retirement savings vehicles.

A third tradition is support for strong regulation.

While other financial service providers opposed the reform measures of the 1930s, the mutual fund industry actively worked for enactment of the [Investment Company Act](#). We have supported tough regulation ever since.

By operating under the strict standards of the Investment Company Act -- daily pricing; prohibitions against affiliated transactions; limits on leveraging; and a system of independent directors -- our industry has avoided the types of scandals that have repeatedly plagued other types of pooled investment funds. Moreover, over the years, while other industries have resisted regulation, we have consistently supported, and even called for, new regulation of our industry to meet new conditions. I submit that the record demonstrates the wisdom of our approach. A recent New York Times story stated that the mutual fund industry's effectiveness "comes from its willingness to accept federal oversight."

This past year was no exception. We supported the [1996 legislation](#), which ensured adequate SEC funding, eliminated duplicative and confusing state regulation, and expanded the SEC's authority over mutual fund books and records. We fought for tough standards to ensure that new [qualified purchaser pools](#) are not marketed to unsophisticated 401(k) participants. We encouraged the SEC's efforts to improve fund risk disclosure, and developed [specific proposals](#) for the Commission's consideration. But we stood hard against mandatory quantitative risk measures in fund prospectuses, because they would confuse, rather than enlighten, investors. We strongly supported the SEC's examination of soft dollar practices.

Our system of regulation has been extraordinarily successful. But we can't afford to sit on our lead. There is a clear need to reform the core disclosure document, the fund prospectus.

Complex prospectuses always have been a problem for mutual funds. In 1941, Walter Morgan, the founder of the Wellington Fund, wrote to the Institute: "Even a C.P.A. can't understand some of the prospectii that are issued now."

The need for a more readable prospectus has become even more evident in recent years, with the growth of direct marketing, and the increasing use of mutual funds in defined contribution plans. On top of this is the general problem of information overload. SEC Chairman Levitt recently stated:

"We are the most wired, signaled, cabled, beeped, paged, plugged-in, on-line, and communicated-to society the world has ever seen. Years ago, the problem was a lack of information; today it is a glut of information."

In order to address these problems, the SEC, under Chairman Levitt's leadership, has proposed the most sweeping reform ever of the mutual fund prospectus. It is based on the idea that a prospectus should be a document that investors actually use. Under the [SEC's proposal](#), there would be a major shift from generic disclosure of technical matters common to all funds, to disclosure of essential information about the particular fund. Moreover, the SEC proposal would permit the use of a shorter profile prospectus, with each investor given the option of either purchasing fund shares from the profile or ordering the full prospectus.

No regulatory change is more needed than prospectus reform. The SEC's proposals reflect years of careful work. The Commission should adopt new rules in this area as soon as practicable.

A fourth, related tradition is our industry's support for a single strong national regulator. For over 60 years, the mutual fund industry has been subject to one set of federal standards administered by one agency -- the Securities and Exchange Commission -- and designed to accomplish one goal -- the protection of investors. Over the years, we have consistently urged adequate funding to permit the SEC to oversee our industry, and we have vigorously opposed fragmentation of regulatory responsibility among a number of different regulators.

But this hugely successful system of regulation is under attack. Some policymakers are urging Glass-Steagall reform that could subject the new financial services holding companies, including the mutual fund components, to banking regulation. This would be a huge mistake.

Banking regulation has as its guiding principle the safety and soundness of banks. In contrast, the federal securities laws value not the soundness of any institution, but the protection of investors. Moreover, imposing bank safety and soundness regulation on securities firms would stifle the vibrancy and creativity of the securities industry. As SEC Chairman Levitt testified:

"securities firms must be able to continue to engage in entrepreneurial, risk-taking activities crucial to the capital formation process without the constraints of bank-like regulation."

The Institute supports [legislation](#) under which each entity in a holding company would be subject to functional regulation -- the SEC would regulate mutual funds, and bank regulators would regulate banks. There is no reason, however, why the mutual fund and other securities subsidiaries of financial services holding companies should be subject to regulation by the Federal Reserve Board.

It clearly is time for Congress to restructure the financial services industry. But restructuring will do far more harm than good if it extends bank regulation throughout our financial system.

A fifth tradition is adherence to high voluntary standards. Justice Brandeis once observed: "The law has everywhere a tendency to lag behind the facts of life." Our industry has long recognized that the lags between the facts of life and the law must be filled by voluntary standards that exceed legal requirements.

This past year, the Institute continued its efforts to improve industry standards and compliance. We published a best practices paper on liquidity and pricing. We've begun work on a similar paper on fund brokerage issues, and on two new guides for fund directors. We have developed a new loose-leaf service to assist funds in offering their shares abroad in compliance with foreign laws. We provided guidance to our members on reevaluating their operations capacity. We also expanded our training programs for fund personnel, and now sponsor about 13 major conferences and 30 seminars and workshops each year, as well as producing a series of self-paced training programs.

This Institute will continue to do all that it can to promote the highest voluntary industry standards. Please keep doing your part. The confidence that shareholders, legislators, and regulators place in our industry will be influenced most heavily by the integrity that each of you display in the individual decisions that you make every day.

This morning, I have discussed traditions that have guided our industry since our inception -

- a commitment to investor education; advocacy of savings incentives; support for strong regulation under a single national regulator; and high voluntary standards -- and how we must adapt these traditions to meet new challenges.

There is another tradition that is vital -- the willingness of participants in our highly competitive industry to work together on issues of mutual concern, and to speak with one voice to legislators, regulators, and the public.

Other industries are fragmented into subgroups and rival associations, who spend an inordinate amount of time sparring with one another, rather than cooperating on common industry goals. In contrast, the investment company industry, with all of its variations -- open-end, closed-end, unit trust, load, no-load, spread-load, independent, broker-affiliated, insurance-related, bank-affiliated, retail, and institutional -- is represented by one association. This remarkable unity has enabled us to achieve a series of notable successes on behalf of our industry and our shareholders, beginning with the Investment Company Act in 1940, through last year's enactment of the [National Securities Markets Improvement Act](#).

A former Chairman of the Institute, Ben Korschot, noted in his recent autobiography that:

"[o]ne of the great achievements of the ICI has been the ability to work, in an unbelievably effective manner, in leading the industry to decisions, where the ICI could speak as one voice for the industry."

Industry-wide cooperation requires leadership and vision from the Institute's governing bodies and staff. But even more, it requires a commitment by each and every member of the industry to put the common good above parochial interests, and to be willing to "give a little" in order to achieve consensus.

We can be proud of our industry's record. Mutual funds provide middle America with professional management and diversification at reasonable cost. We operate within a culture and regulatory system that puts investors first. And, in over seventy years of operation, mutual funds have not cost the American taxpayer one cent.

In order to succeed in the future, we must remain true to our traditions -- educating investors, supporting strong pro-consumer regulation, and adhering to high voluntary standards. But, above all, we must continue to work together in the interest of our shareholders.

In conclusion, I wish that Ellie and I could do what we did twenty-three years ago, and invite all of you over to our home. But given the size of today's audience, that's clearly not possible. So instead, please join me at lunch, and at the reception and dinner later this evening.

Thank you.