

SPEECH

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Revolution in Real Time: Using the Internet to Inform Investors Better

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Thank you, Jim. That was a very generous introduction. But then, as a newlywed, you must be in a happy frame of mind. After all, it's Valentine's Day. This is a day for candy, flowers and romance. A day for greeting cards and love notes – and the feast of a famous saint of the 3rd Century.

Today, however, I want to talk about 21st Century communications – specifically, communicating with current and future investors in the Internet Age. As you know, since coming to the SEC, Chairman Christopher Cox has been championing the Internet as a groundbreaking tool for informing investors. I know you all join me in wishing him a speedy and complete recovery from his recent surgery.

He recognizes, as should we all, that technology is giving us an historic opportunity – the chance to serve investors' information needs even better. Never has this objective been more important than it is today – when people have increasing responsibility to assure their own long-term financial security.

In the remarks that follow, I will cover several points.

First, the phenomenal growth of the Internet as a medium of communication.

Second, the evolution of regulatory thinking about the Internet. It has been evolving, although not quite at a pace as yet to match the growth of the Internet itself.

Third, [research that the ICI is releasing today](#) – showing the surge in Internet use among

mutual fund shareholders, and demonstrating its importance to them as investors.

Fourth, and finally, the great potential of the Internet to better inform all who participate in the securities markets – especially the millions of Americans who invest in mutual funds.

The Rapid Rise of the Internet

Consider the impact the Internet has already had on the world of investing. It wasn't that long ago that sending someone information right away meant the next day, by overnight package. Or – if it was really urgent – feeding a huge, multi-page document by hand into a fax machine. Research meant going to a library, sorting through a card catalogue, prowling stacks of books, looking at microfiche, or paying a service bureau to obtain documents.

No longer. The Internet, in a sudden leap forward, has changed all that. Suddenly, we have a world of information at our disposal, in real time, anytime, and virtually anywhere.

Some changes take place so quickly that we don't notice how important they are, or how rapid the transformation, until they are quite entrenched. The Internet is one of these. Do you remember the first time you logged on? I had my first email account in January 1987. It's not that I'm an early adopter. I was working on the National Security Council staff at the Reagan White House, and we were using an early email system that IBM had developed – what was known as the PROFs system. It attracted a bit of notoriety at the time. You may recall the email traffic associated with the Iran/Contra affair. It was an early lesson that the Internet can provide a great many things – but judgment isn't one of them.

The Internet is unique among technological transformations in how rapidly it has spread. It's amazing how quickly the Internet reached critical mass, compared to earlier technologies.

It took 38 years for radio to reach 50 million users. It took television 13 years to reach that level.

How long did it take before 50 million people had access to the Internet? Four years.

In 1900, only 2 percent of households in the U.S. had electricity. It took 50 more years before 80 percent of households had it. Eighty percent – that's about the level of Internet access today, and we've reached that level in just over a decade.

People were quick to see the value of being able to send and receive messages in real-time, and access huge volumes of data, while they are sitting in their office or den. Now, we take for granted being able to do the same thing sitting in a restaurant, a taxi or an airport lounge. In fact, it's hard to stop. Yes – I'm talking to any of you who have checked your Blackberry or Treo at least once since I began this speech.

And the Internet Revolution shows no sign of cresting, with new technologies every day making it possible to send and receive information more efficiently -- wherever and whenever people choose.

The Internet's Growing Importance to Investors

What impact is this change having on investors?

Consider how many already depend upon it. For growing millions of Americans, the Internet isn't just a news supplement – it's the financial pages, the financial news network and the

ticker, all rolled into one. Increasingly, it's the first place they turn for information – real time information, perhaps several times a day.

Investors can read company news releases the moment they are issued, and view corporate filings at the SEC website. Many arrange to be notified every time a company they are interested in makes news.

Financial sites are among the most popular on the Web. Mutual fund companies provide a wealth of information online. Fund websites cater to the needs of both individual fund investors and financial advisers that assist fund investors.

And fund companies are very adept at using the Internet as an educational medium. Their websites feature extensive educational material, including information about the fundamentals of investing, saving for college, estate planning, tax and retirement planning. Many have developed interactive online calculators and other tools.

Regulatory History

If the Internet has drastically re-shaped the way people communicate and access financial information – to what extent has our regulatory environment kept up?

As the Internet has developed, the SEC increasingly has recognized the medium's utility – and sought to take advantage of it, to make vast amounts of information easily accessible to the public. Its EDGAR database, for example, makes real-time filing and other company information readily available – to the benefit of all market participants.

The SEC also has taken steps to adopt regulatory policies that permit required information to be furnished via the Internet. In this, it has moved somewhat cautiously.

Initially, the SEC sought to satisfy itself that the Internet was a rough equivalent of paper in its ability to meet investors' information needs – lest the electronic medium somehow shortchange investors or place undue burdens on them. Now, the SEC has begun to recognize the potential of the Internet to offer a superior way to convey information to many investors and other market participants. Chairman Cox has suggested that the time is now ripe for the SEC to craft a regulatory regime that takes far better advantage of the potential of electronic communications.

The Chairman has been articulating the need to make the best possible use of the Internet and other technologies, not only so investors can access information faster, but also as a way to make the information better. As he has said: "Down the road, I hope that we can exploit the potential of the Web to provide disclosure that can be customized to each investor's tastes — starting with clear summaries, and drilling down into as much detail as one wishes. By aiming our rules at the creation of more investor-friendly data that can be analyzed and massaged ... the SEC can help put more, and more useful, information in front of investors than ever before."

The SEC Chairman has stated that the "ultimate goal is to put investors in the driver's seat when it comes to information about, and control over, their money."

Chairman Cox's push to take advantage of technology to provide investors with more useful information echoes the sentiments of other senior policymakers.

NASD Chairman Robert Glauber has said that "Using the Internet for ... disclosure moves us

into the 21st Century, so that investors have an alternative to more piles of paper.” Like Chairman Cox, Chairman Glauber has recognized the benefits that technology has to offer. Speaking about the information NASD believes mutual fund investors should get from brokers at the point of sale, Mr. Glauber has commented that “Internet delivery would be a big step forward, allowing investors and brokers easy access to these disclosure documents, simplified comparison of one fund with another, and a platform on which to build analytical tools.”

Congressman Richard Baker, Chairman of the Capital Markets Subcommittee of the House Financial Services Committee, likewise has pointed out the power of technology to facilitate sound investment choices – for example, in the area of “comparability, not only peer-to-peer, but peer to sector, however you want to compare” different funds.

There is growing recognition that the time has come to take greater advantage of the Internet to provide investors and other market participants with more timely and more useful information about mutual funds. Technological and market structure developments in recent years justify this position. As I will demonstrate today, so, too, do developments concerning mutual fund investors’ access to and use of the Internet.

The Investing Public’s Comfort Level with the Internet

Quite wisely, the SEC has sought to pace its reforms around growing public and investor comfort with the Internet.

One thing seems clear: the Internet today is an important and growing source of information for the public.

Consider a [study released by Arbitron](#) in 2002. When asked Which of these media is MOST essential to your life?, 20 percent of those surveyed said the Internet, compared to 11 percent for newspapers.

Among those with a four-year college degree or better, 30 percent said the Internet, compared to 13 percent for newspapers.

According to Ball State University’s second Middletown Media study, conducted last year, the Internet is the most heavily used information medium among those aged 18 to 34. That study also found that, on average, Americans spend more than an hour a day browsing the web.¹

The SEC, like others, has recognized that Internet use has expanded greatly. According to a study conducted by Nielsen/NetRatings– and cited by the SEC – in 2004 up to 75 percent of all Americans had access to the Internet in their homes. This finding is consistent with the Pew Internet Survey and Mediamark Research’s study, both conducted in 2005 and both showing that Internet access has increased substantially over the past five years. Indeed, at the current rate, Americans’ use of the Internet is approaching the overall literacy rate.

Internet use has not just grown – it has grown among all segments of the population, whether considered by age, gender, race or ethnicity.

Remember the early Internet generation gap – with younger users adapting fast, and older users more slowly? Well, that gap has shrunk substantially.

According to Mediamark Research, in 1997 only 8 percent of Americans 55 years of age or

older had Internet access. Now, close to two-thirds do.

Internet use is growing among Americans of all educational backgrounds. In 1997, only 10 percent of those with a high school education or less had access. Now, close to two-thirds do.

In 1997, only 14 percent of those with annual household incomes of less than \$50,000 had Internet access. Now, close to two-thirds do.

By age, by education, by income – Internet use has grown rapidly among the general population.

Not surprisingly, the ICI takes considerable interest in the further question of Internet access and use among investors – specifically, fund investors. After all, how successfully the Internet can serve as a disclosure vehicle depends on how many investors have access to it, how frequently they use it, and how comfortable they are with it.

That is why I want to share with you the principal results of a study of mutual fund shareholders and their use of the Internet that we conducted last year. We surveyed a randomly selected sample of 3,000 U.S. households – a sample representative of all U.S. households and of all U.S. fund investors. To our knowledge, this represents the most comprehensive and up-to-date information available on fund investors' use of Internet technology.

The results demonstrate that mutual fund shareholders are very much “logged-on.” In fact, it is clear that the Internet is one of the chief financial tools they use.

Fund investors typically have had a relatively high Internet usage rate. That has increased even further, in lock-step with investors' comfort level – justifying a wider use of the Internet for fund disclosure purposes.

We found that nearly 90 percent of mutual fund investors have access to the Internet at work, or at home, or both. About two-thirds of those with Internet access go online at least once a day. Almost another quarter goes online at least once a week.

Mutual fund investors use the Internet for financial purposes. Three quarters of those who go online use the Internet to access their financial and investment accounts. Nearly 60 percent of fund investors who go online use the Internet to obtain investment information.

And our study shows that Internet use also has grown dramatically among all segments of these investors.

We found that, in 2000, only 30 percent of fund investors age 65 or older had Internet access – now, it's more than 60 percent. In just 5 years, Internet access has almost doubled among fund investors with a high school education or less – to 72 percent. And it has increased by almost two-thirds among those with household incomes less than \$50,000 – to more than three-quarters.

That a higher proportion of mutual fund investors have access to the Internet – as compared to the general public – should not be surprising. Mutual fund shareholders, for example, tend to have higher incomes and to have attained a higher level of education than the overall U.S. population.

Our findings on Internet access and usage confirm that mutual fund investors are comfortable with Internet technology. They use it – and they rely upon it. The Internet clearly has enormous potential as a tool of investor information and education. The question is: How can we use this tool to improve the accessibility, utility and quality of the information we provide?

Mutual Fund Disclosure Reform/Internet Disclosure

I believe we can start by looking at how we can use the Internet to solve a set of conflicting pressures. There is widespread agreement that today's disclosure system is not optimal from the fund investor's perspective. Most investors seek information that is clear and concise. They value quality, not quantity.

But mutual fund prospectuses have been caught in a version of the movie "Groundhog Day." Over the years, a lot of hard work has been done to simplify fund prospectuses, to translate them into plain English, to make them more useful and comprehensible to average investors. Over and over, this work has been thwarted by a stream of new, additional, detailed disclosure requirements. To be sure, each new disclosure item may be of genuine interest to some element of the market. Nevertheless, this mass of disclosure discourages the far larger population of investors from ever consulting their fund's prospectus – ironically, the very document that is intended for their use.

We saw proof of this quality vs. quantity dilemma as far back as the mid-90s. With the encouragement of the SEC, the ICI and eight mutual fund groups developed a model disclosure format that would provide investors with essential information that was easily read and digested. Studies found that mutual fund investors far preferred this approach. They found it more usable, easier to understand, and more helpful in making investment decisions.

An ICI survey found that over 60 percent of fund investors who had not consulted the required prospectus said they would be very likely to use the concise version. A substantial majority of mutual fund investors said they would like to receive it – provided the lengthy, required prospectus would be available upon request.

In other words, investors were indicating their own way out of our dilemma. It's simple. It's called choice. The Internet makes it possible to give it to them. The Internet offers the ultimate a la carte menu: Those who want more extensive information can get it. Those who don't can access or be provided the essential information they need, in a form they are likely to use. Talk about a revolutionary idea – imagine fund disclosure that is concise and to-the-point and that an average fund investor might actually read! The Internet thus provides a framework that will serve the needs of every investor and the marketplace at large. It would also assure unfettered access to the full gamut of information that some investors – and regulators, the media, analysts and intermediaries – want and use.

So it's no longer a question of either-or, of less versus more. Thanks to the Internet, we can provide both less and more. We can inform millions of average investors more effectively, and put them in control, as Chairman Cox has said, when it comes to information about their mutual fund investments.

To make this approach work, the SEC will need to revamp the existing mutual fund disclosure system. That's a tall order, but the SEC, under the leadership of Chairman Cox, is up to the challenge. The ICI stands ready to assist in every way we can.

Through a full-scale disclosure reform effort that incorporates use of the Internet, we can provide information that investors can use. We can snap the Groundhog Day cycle of complexity.

Guiding Principles of Reform

It comes down to this: There is a revolution in communications technologies – a revolution in real time – and we need to get ahead of it. We need to shape clear principles that can guide regulatory policy in the face of rapid, continuous, and dramatic change.

Shaping these principles must involve the participation of a wide range of stakeholders. It must include the users of Internet information, and the creators of it – and regulators.

We know as a starting point that our guiding principles need to include universal ease of access to information.

Above all, we must strive to help current and potential future fund investors better understand mutual funds and the process of mutual fund investing.

A framework that relies on Internet disclosure also must accommodate people who do not have Internet access, or are not comfortable with it. Even as they represent a declining share of the investor population, we cannot ignore their needs.

Conclusion

Chairman Cox and the SEC have made it clear that they recognize changes in technology and the needs of investors. Now, the Commission has an historic opportunity.

Consumers of financial information are comfortable with electronic communications. The ICI survey illustrates that this isn't something out there on the horizon. Particularly for fund investors, the future is here – NOW.

When it comes to improving fund disclosure, we must harness the tremendous potential of the Internet. Its potential value to investors is enormous. We must ensure that they can make the most of it.

It's time to make the fullest use of the technology available so that investors have the information they need, all the information they want, in the format that makes it as valuable as possible for them. This indeed would constitute another leap forward in the democratization of investing, a transformation in which mutual funds have played so central a role.

It's time for the stakeholders to work in partnership with regulators to make this happen. The mutual fund industry is prepared to do its part. Our investors deserve no less.

Endnote

1Middletown Media Study

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