SPEECH

May 6, 2015

Chairman's Address, 57th Annual General Membership Meeting

Chairman's Address
57th Annual General Membership Meeting

F. William McNabb III
Chairman and CEO
Vanguard

May 6, 2015
Washington, DC

As prepared for delivery.

Thank you, everyone. And good afternoon. Thank you to George Gatch for that very nice introduction.

I'd also like to thank George for chairing this event. George and his fellow GMM Planning Committee members worked with the ICI to create an incredible program for the next three days. So, a big thank you to George and the entire team!

Over the past two years, I've had the honor and privilege to serve as the Chairman of ICI. The post provides a unique vantage point on the mutual fund industry as a whole, and the investors whom we all serve.

And for me, the role has served to reaffirm the foundational principles that have been so important to us historically, and that will be critical to our efforts to serve investors long into the future. I'd like to share five of those principles with you this afternoon.

The first principle may sound like an opinion, but after seven-and-a-half decades, it's a simple statement of fact: The Investment Company and Investment Advisers Acts of 1940 are remarkable pieces of legislation. The video that we just watched told the story well. The Acts have stood the test of time, and they have provided the structure for an industry that, today, is highly regulated—and fairly regulated—and focused on what's in the best interests of investors.

As we gather here today and celebrate a piece of legislative history, our current regulatory outlook is very uncertain. I find it instructive to recall the historical context of the 1940

Acts:

- They were written and enacted in the years following a global financial crisis.
- They were based on years of open and transparent research by the SEC—the single regulator charged with overseeing the industry.
- They were created with the input and support of the investment industry.
- They were passed with bipartisan support.
- And—if it's possible for a stack of legislative documents to have a soul—the soul of the '40 Acts is one of "fiduciary responsibility."

The second principle that has been reaffirmed for me over the past few years is this: Mutual funds have democratized investing. They have transformed investing from the exclusive practice of Wall Street professionals into a common practice of everyday Main Street individuals.

And the investment companies here today have provided investors with the funds, services, and education to make that happen. Our efforts have made investing easier, cheaper, and safer for people over the years.

Just think: Today, a person can own the entire global stock market for less than 20 basis points—and, with that, have access to a very rich array of portfolio tools, investment education, and insights.

From a pure numbers standpoint, the adoption of mutual funds has been an incredible story.

- Over the past 75 years, the U.S. population has grown by a factor of about two-and-a-half—from 130 million people in 1940 to 320 million people today.
- Over that same span, mutual fund ownership has grown by a factor of more than 90 (from fewer than 1 million mutual fund investors in 1940 to more than 90 million today.)
- In 1940, there were less than 100 open-end mutual funds in the United States. Today, there are roughly 8,000.
- In 1940, there were about $400 million in assets invested in mutual funds. Today, that total has risen to more than $16.1 trillion.

Of course, there are many different ways to measure the "reach" of mutual funds. But my favorite is hearing directly from investors. Sometimes my colleagues at ICI will pass along excerpts from shareholder letters. I'd like to read you a few lines that someone recently passed along to me:

[I] just wanted to express my deepest gratitude for all the things you do....It is because of [your company] that a person of modest means such as myself can have a fair chance toward a decent retirement. Even though I am a late bloomer in the investment world, and have very little to invest every month, I have learned to set a plan based on goals [and] how the markets work....With patience and discipline, I can now fathom a safe retirement.

Wow—now, that's the kind of note you want to hang on your bulletin board! And it's a reminder to all of us that what we do—is important work.

The third foundational principle that has been reaffirmed during my time as ICI Chair is that innovation drives us forward. It's a simple concept from Business 101, but it's been the key to our evolving story—a story that started with Massachusetts Investors' Trust in 1924—the first open-end mutual fund in the United States. As George pointed out, funds in a wide range of categories have improved the way that this industry serves investors:

- Money market funds
- Index funds
- Bond funds
- Municipal bond funds
- International funds
- Target-date funds
- Exchange-traded funds

The video touched on some of these earlier. Each of these innovations is an example of the mutual fund industry giving Main Street investors the chance to invest in a manner that institutions and wealthy individuals have had for decades.

We've also pushed each other to improve the client experience. Consider the quality of investor education today...and the ease of online interaction...and the decades-long decline in costs for investors. It's terrific progress.

And now, as I look around, I see a roomful of fierce competitors, and I know that we all spend time thinking about what that next great innovation will be. That's good news for investors everywhere.

The fourth principle I'll mention is that mutual funds are going global in a big way. And I'll use the phrase again: That's good news for investors everywhere. Now, of course, we can look at "globalization" through two lenses.

The first is from the viewpoint of the U.S.-based investor, who is gaining a more global perspective. Currently, U.S.-based mutual fund investors have 26 percent of their equity investments in international stock funds, up from 14 percent in 2000—meaning their allocation has almost doubled. And this growth is accelerating—over the past 15 years, cumulatively, U.S. mutual fund investors have directed more of their equity cash flows into international stocks, while pulling money out of domestic equity. In other words, they are steadily increasing their international exposure, and this trend is continuing.

And most of you here today are talking about global solutions for your clients at this point. According to analysis that Vanguard has done with Morningstar, if you look at the five largest providers of target-date funds, the average allocation to non-U.S. equities is 32 percent.

The second lens on globalization is the actual democratization of investing that's occurring around the world. Again, many of the firms represented here today are doing significant work outside of the United States. There are about 80,000 mutual funds in the world today; 8,000 of those are in the United States. That means 9 out of every 10 funds is based outside the United States. The growth in non-U.S. funds, ETFs, and assets has been extraordinary—and, in a sense, we're just beginning.

The first four principles that I reflected upon are "good news stories." They're fun to think about:

- fair and strong regulation
- the democratization of investing

- great product innovations
- and the globalization of our industry.

The fifth and final principle is this: We must never forget our responsibility to investors.

Mutual funds and their investors have benefitted from a strong regulatory framework for 75 years. And the SEC, today under the leadership of Mary Jo White, has shown its strength as the ultimate protector of investors and overseer of the financial markets.

The issues that regulators are wrestling with today are more complicated than ever—but no less important. As an industry, we must embrace our role as stewards, and work with regulators to protect the interests of investors.

But if we become complacent...if we fail to act in the interests of our investors...if we become divided as an industry...then our regulatory framework could change significantly—and investors will suffer.

Right now, the U.S. Financial Stability Oversight Council and the global Financial Stability Board are considering measures to impose additional layers of regulation. Mutual funds and their managers could fall under the supervision of the Federal Reserve Board, for example. And certain funds and managers could be designated as systemically important financial institutions, or SIFIs.

This could mean many different things—none of them appealing.

- Capital requirements for funds and firms.
- Additional layers of regulatory fees.
- The potential for mutual funds—and their investors—to be on the hook to bail out a failing financial institution.
- Brand new fund regulators wondering what other changes they should make.

FSOC and FSB say they want to protect taxpayers from the prospects of future bailouts. But their apparent intentions to impose bank-like regulations on the fund industry are unnecessary, inappropriate, and harmful. If these plans take hold, the 90 million Americans who have invested their hard-earned money in mutual funds could be forced to once again bail out “too big to fail” financial institutions. It would be just another form of a tax on Main Street.

Mutual fund investors are facing a very real threat. We have a responsibility to serve as their voice and to act in their best interest. As I said earlier, we are stewards of our investor’s hard-earned capital, and we must never forget that. I believe the future for investors is bright, but it will take all of our collective efforts to make it so.

We have a great program ahead, and I am looking forward to the important discussions we’ll have here over the next three days. Thanks very much for your attention, and enjoy the meeting.

Now, we’re pleased and honored to open our conference with Walt Bettinger, president and CEO of Charles Schwab Corporation, who will have a Policy Forum conversation with ICI President and CEO Paul Schott Stevens. Paul will begin by introducing Walt. Please welcome Paul Schott Stevens.