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Promoting Excellence in Fund Governance

2004 Securities Law Developments Conference: Opening Remarks

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Good morning. I am Elizabeth Krentzman, General Counsel of the Investment Company Institute, and I'd like to welcome you this morning to the 2004 Securities Law Developments Conference.

Coming as it does at the end of the year, this annual conference gives us the opportunity to look back at significant developments in mutual fund regulation during the past 12 months, and to consider their likely impact on funds and fund shareholders going forward. Clearly, we have a lot to talk about over the next two days.

To start us off this morning, I would like to say a few words about what we all now refer to as "the scandal." I would then like to briefly look forward, and to explore how industry members, the Institute, and regulators can strengthen the industry and prepare it to meet the challenges ahead for the good of all investors.

Without a doubt, this past year has been a difficult and challenging one, and I am proud of how our industry has responded. We swiftly denounced the wrongdoing. We renewed our commitment to put the interests of fund shareholders first. We supported the SEC's reform agenda. And fund firms continue to work tirelessly to implement the new requirements.

Two of the SEC's proposals – the hard 4 pm close and redemption fees – remain outstanding. Some have seen irony in the SEC's adoption of so many other new requirements for funds, while these two reforms – which go to the heart of the scandal – have not yet been acted upon. As I see it, the SEC is fully justified in taking a deliberate approach on these extremely complicated initiatives because it is so important to get them right. The Institute is currently working with the SEC staff and others to develop workable solutions that will protect fund investors against late trading and abusive market timing. We hope to see the results of these efforts in early 2005.

As we put the scandal behind us and move toward a renewed focus on compliance efforts and our commitment to fund shareholders, there is something remarkable that we learned from the events of the last year. Shareholders can – and, in fact, do – vote with their feet. Consider that fund companies named in investigations or enforcement actions at the end of 2003 experienced combined outflows of $9.4 billion per month in their bond and stock funds from September 2003 through March 2004. In contrast, companies not named in enforcement proceedings registered combined inflows of $35.3 billion per month over the same period.

This sends a very effective message to our industry on the importance of meeting fiduciary responsibilities to fund investors. It also underscores the fact that investors are fully capable of expressing dissatisfaction (or satisfaction) with fund management. I believe this should be kept in mind as the SEC develops regulatory policy.

As we begin to look forward – past the scandal and its aftermath – to the challenges and opportunities that lie ahead, let's also not forget the vital role that mutual funds play in our everyday lives. Mutual funds remain the best game in town for average America, providing us with professional investment advice, diversification, and a range of valuable services, all at relatively low costs. We look to fund shares when we save for college through 529 plans, invest for retirement through IRAs and 401(k) accounts, and manage our cash through money market funds. I very much concur with the observation of the Institute's President, Paul Stevens, that: "Mutual fund investing is [indeed] a powerful proposition."

Given the importance of mutual funds to American investors, it is imperative for all of us – funds, the Institute, and regulators alike – to consider how our actions will affect fund shareholders and the overall health of our industry.

We must make every effort to reexamine, with a fresh eye, accepted business practices and existing regulatory requirements. Is each achieving its purpose? Does any practice or regulation carry with it unintended consequences?

We should be asking, “Is there a better way to do this?” As Thomas Alva Edison once said, “There is a better way for everything. Find it.” I believe we can find these better ways by thinking creatively and “outside the box.” New approaches may be revolutionary – like the development of money market funds nearly 30 years ago – or they may simply be a fresh way of dealing with issues that have been around for a while.

New practices and proposed regulations likewise deserve the same rigorous scrutiny. In each case, we must ask, “Does the practice or regulation ensure that the interests of investors come first?”

In my view, we also must do a better job of weighing costs and benefits when it comes to proposed new regulations. Specifically, we must determine whether the benefits of a proposed regulation justify the costs of compliance, which are ultimately borne by fund shareholders. It is also no secret that costs associated with additional regulatory requirements fall disproportionately on smaller fund companies, which have smaller asset bases and potentially smaller margins to absorb the costs.

Let me be clear – I am not suggesting abrogating regulations that protect investor interests or that small funds should receive special dispensation. Rather, I am urging the SEC to examine carefully the increasing impact that costs have on the vitality and viability of the fund industry. The benefits of new regulatory initiatives need to be measured against fund costs and burdens to avoid undesirable consequences that diminish those intended benefits.

I also believe that regulatory actions need to be evaluated more broadly. For the most part, regulations focus on conflicts of interest and other issues solely as they relate to funds, when there are similar conflicts and issues that affect investors in other contexts. The NASD Mutual Fund Task Force recently looked at issues relating to soft dollars with this very kind of broad perspective.

Specifically, the Task Force report recommends that the SEC consider making compliance with the standards under Section 28(e) mandatory not just for investment advisers to mutual funds but for all discretionary investment advisers, whether or not they are registered with the SEC. Even more broadly, the report suggests that the SEC recommend to the Department of Labor and to federal banking regulators that they, too, should require all other discretionary investment managers to comply with the standards of the safe harbor. I strongly encourage the SEC to act promptly on these sound recommendations.

Another area where the same degree of protection afforded to mutual fund investors should be afforded to investors generally is with respect to disclosure. For example, individuals who invest in mutual funds through a defined contribution plan typically receive important information about a fund's investment objectives, performance, and fees. With other types of investment products, plan participants may receive far less.

I recently testified on behalf of the Institute before the Department of Labor's ERISA Advisory Council that all plan participants should receive enhanced disclosure. In particular, we recommended that participants in Section 404(c) plans – that is, plans that allow participants to direct their own investments and that meet certain other requirements – be provided with disclosure comparable to that provided in a mutual fund profile with respect to all pooled investment options under the plan. This recommendation makes sense because participants in Section 404(c) plans who select mutual fund options are already required to receive a copy of the fund’s prospectus or profile. I’m pleased that the Advisory Council has developed recommendations for consideration by the Department of Labor that are largely consistent with the Institute’s suggested approach.

As I have outlined, charting the proper course for the future of the mutual fund industry will require us to think and act proactively and comprehensively. But by working together, and making sure that the interests of investors come first, I am confident that we can assure a bright future for the industry and the millions of investors who place their trust in us.

Before I introduce our keynote speaker, let me say just a few words about the rest of our conference program. As you can see from your materials, you’ll be hearing from a distinguished set of panelists from the industry, the SEC, and the NASD. We’re particularly pleased to welcome Steve Cutler, Director of the SEC’s Enforcement Division, as our luncheon speaker. I would like to thank all of our program participants for the time and effort they have devoted to this conference.

On our agenda for tomorrow morning is a presentation that departs from our usual panel format. Given the energy and resources that fund companies have devoted this year to the new compliance rule, our compliance forum will give you the opportunity to hear from several Chief Compliance Officers about the challenges their companies have faced in implementing the rule. This view from the trenches also should give us valuable insight into the compliance challenges still to come.

To get us underway with our program, let me turn now to Paul Roye who, as most of you know, is the Director of the SEC's Division of Investment Management. Paul has not been in an enviable position during the past year, but the Division's many accomplishments over this period are a testament to his leadership and his commitment to the interests of fund shareholders. Please join me in a warm welcome for Paul.
