Independent Directors Council

Promoting Excellence in Fund Governance

Commentary: Maintaining the Industry's Reputation and Our Investors' Confidence in Difficult Times

Maintaining the Industry's Reputation and Our Investors' Confidence in Difficult Times

by Paul G. Haaga, Jr.

Mr. Haaga was elected Chairman of the Institute in October 2002.

The mutual fund industry's reputation is its most important asset. Strict regulation and the industry's adherence to the highest possible voluntary standards have helped us avoid major scandals. Recent corporate wrongdoing has made it even more imperative that we work to maintain our reputation for serving our shareholders responsibly. Despite our stellar record and practices, an industry like ours, which represents 95 million shareholders, remains of significant interest to Congress, regulators, the media, consumer groups, and others.

In times such as these—where public confidence in the markets and the business community lags—we are presented with an opportunity to pause and reflect on where we stand in meeting a crucial goal: serving our shareholders.

Taking a Stand for Effective Regulation

We have long supported and embraced the Investment Company Act of 1940, which has helped shield us and our shareholders from wrongdoing and promoted good business practices. It is not surprising, therefore, that our system of governance has served as a model for the New York Stock Exchange and others now seeking to strengthen corporate governance systems.

While mutual funds consistently have sought improved accountability, strengthened oversight, more meaningful disclosure, and more effective regulation, we oppose efforts that would harm our shareholders or that would not add meaningful protection to justify their costs. One example is the SEC's proposal relating to proxy voting by investment companies and their advisers. The fund industry has always taken seriously its responsibilities with regard to proxy voting. We believe that the SEC can better accomplish its proxy voting objectives on behalf of fund shareholders by requiring (a) fund advisers to adopt and disclose proxy voting policies and procedures, (b) fund directors to approve these policies and procedures and to oversee their implementation, especially in areas in which there may be potential conflicts, and (c) advisers to maintain proxy voting records.

In the current rush to reform, our critics contend that our refusal to embrace every single aspect of every suggested regulatory initiative—however ill-conceived—makes us virtual co-conspirators with the Enrons and WorldComs. We must maintain the courage to resist inappropriate or harmful regulation in the face of criticism—our shareholders deserve no less from the people to whom they've entrusted their life savings.

Restoring Public Confidence by Reinforcing Realistic Expectations

Reinforcing the need for realistic expectations by our shareholders can help restore investor confidence in the markets. Investors who have long-term goals and who expect the inevitable market gyrations are more likely to make rational decisions for their own good in all market conditions.

Mutual fund investors have consistently demonstrated a long-term investment perspective. Institute research finds that nearly half of all U.S. households own mutual funds, that these investors are not overly concerned with short-term market fluctuations, and that they believe their investments will recover from a bear market.

Fund investors' resiliency is due in no small part to the industry's ongoing efforts to keep them educated and informed. Amid the high-flying tech rally of the 90s, for example, the Institute cautioned investors that extraordinarily high equity returns were unsustainable. More recently, as interest rates have reached historic lows and boosted bond prices, we cautioned investors about the impact of rising rates on bond prices. Setting realistic goals, understanding the relationship between risk and reward, and recognizing the benefits of diversification are pillars of our industry's long-standing investor education programs, and we have consistently advised investors to temper their expectations in strong markets and not to lose faith in weak markets.

The industry must persist in conveying these messages. Market conditions may change, but our message to investors must always remain the same: maintain realistic expectations.

Realistic Investor Expectations Breed Public Confidence

In a recent statement, the Institute explained the effect of interest rates on bond prices as part of an industry-wide effort to help investors develop realistic expectations about their bond investments. As shown below, during periods of rising interest rates (shaded areas), the price of intermediate U.S. government bonds dropped (as measured by the year-over-year percentage change in the bond price index).

Investors Must Continue to Show Fortitude

Our industry's investors have demonstrated fortitude in these challenging times. We must continue to show our commitment to them through our efforts in Washington and across the country. As we renew our efforts on behalf of investors, I am confident that we will weather these difficult times and maintain our reputation for serving shareholders responsibly.

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