

2005 Annual Fund Directors' Conference: Welcoming Remarks

11th Annual Directors Conference

Welcome Address by

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Good morning. I am pleased to join Jim Bodurtha and the Institute's new Chairman Marty Flanagan in welcoming you to this year's Directors' Conference.

We owe special thanks to Jim and to the governing council of the Independent Directors Council for their outstanding work, including their work in organizing this conference. As they would readily acknowledge, none of this would be possible without the direction and assistance of Marguerite Bateman, the Managing Director of the IDC, and Lisa Hamman, Assistant Counsel to the IDC.

The Role of the IDC

It was only a year and a half ago that the IDC was formally launched, as a dedicated office within the ICI to focus on the needs of independent directors. The IDC already has amassed a record of significant accomplishments. This conference, however, has been the leading educational forum for fund directors for far longer. I am quite proud to have been at the ICI and personally involved with organizing the first Directors' Conference, launching the first Directors' Practices Survey and organizing the Director Services Committee (the predecessor of the IDC)—all a decade and more ago.

The ICI is not new to these issues. Indeed, we have a long record of support for independent directors and for sound fund governance. The best practices for mutual fund directors, issued by an ICI advisory group in 1999, were years ahead of any legal and regulatory requirements. The IDC is the most recent—and a very powerful—expression of our commitment. Today, the IDC is integral to the Institute's mission to advance the interests of funds and their investors. Its work in just this past year has proven to be of immense value to directors.

My many visits with fund boards since becoming ICI President make it clear that we must do all we can to help independent directors succeed in their important role on behalf of shareholders. That role has become more challenging, and directors have come under closer scrutiny, than ever before. The issues confronting you as fund directors are complex and constantly evolving. In this environment, you require the highest-quality continuing education, accurate and timely information about a range of regulatory developments, careful analysis of industry trends, and sound perspective on the many tasks that boards share in common. The IDC, and the ICI more broadly, are dedicated to meeting these needs.

The Fiduciary Partnership Central to Mutual Funds

I attended my first fund board meeting 25 years ago. My private law practice consisted to a large degree of work as fund counsel and counsel to independent directors. In my experience, the best outcome for shareholders is reached through a candid, comprehensive, and ongoing dialogue between independent directors and fund advisers, both of whom have fiduciary obligations to fund shareholders. They may not always agree on specific measures. But at the end the day, both owe their loyalty to fund shareholders. For fund advisers, remaining true to that fiduciary obligation is not only the right thing to do, it is the only successful business strategy.

The success of this fiduciary partnership—a central feature of mutual fund investing in the United States—is a matter of deep concern not just to fund companies, fund directors, and fund shareholders. It is vitally important to our nation itself. Indeed, saving

and investing has become a public policy imperative of enormous consequence.

The Importance of Mutual Fund Investing

The Commerce Department has reported that since June 2005 the personal savings rate has gone into negative territory—the first time this has happened since the early 1930's. This continues a steady decline from over 11 percent in the early 1980's. As a society, our consumption today exceeds our disposable income, and we are not making provision for future needs. This trend is not sustainable, and if it long continues will impact us all and generations of Americans yet to come. It is imperative that we facilitate and support the efforts of the millions of Americans who actively save, respond to the needs of millions of others who have the desire to do so, and motivate millions more to begin and keep saving.

This has been a key role of America's mutual funds. Nationwide, about 43 million 401(k) plan participants have accumulated more than \$2 trillion in their 401(k) accounts. How have these investors accumulated this impressive nest egg? Through their employer's plan, they got into the habit of investing. Contributing little by little, paycheck by paycheck, through bull and bear markets, they continue to make steady progress toward their retirement goals.

Recent [collaborative research](#) between the Employee Benefit Research Institute (EBRI) and the ICI finds that Americans who continuously maintained 401(k) accounts from 1999 through 2004 saw their average account balance increase by 36 percent over the five-year period despite one of the worst bear markets since the Great Depression. That's right—even through one of history's worst market calamities, the steady approach served investors well. It is no surprise that about half of the 401(k) retirement nest egg is invested in mutual funds. In addition, retirement savers accumulating assets in IRAs held \$3.5 trillion in assets at year-end 2004, with 43 percent held in mutual funds.

Read the pages of the financial press and you might conclude that success, in this context, is all about "beating the market." In the real world, I suspect ordinary investors do not think of success in these terms. Nor should they. For them it's not a game of "Texas Hold-em." Instead, they are committed to a more lofty yet simpler goal—meeting their own long-term financial needs. And they recognize that the best way to do that is the old-fashioned, tried-and-true, steady approach to investing. Virtually all mutual fund investors state that the money they have in funds represents savings for the long haul.

Fund Fees and Expenses

For long-term investors, cost is one important consideration among many others. So, please allow me to comment here briefly about the issue of fees.

There are, of course, a lot of contending views about mutual fund fees. There are an awful lot of numbers thrown about. Sometimes it seems that mutual funds have replaced baseball as the leading cause of statistics. It is easy to lose sight of the most basic facts, so let me cite just two that everyone discussing mutual fund fees ought to bear in mind.

First, what is the long-term trend? ICI has examined how the cost of owning mutual funds has changed since 1980, taking into account sales charges, 12b-1 fees, management fees, and all other operating expenses. Over this period, the cost of owning funds has declined nearly half. Let me repeat that: over just about a quarter-century, the total cost of owning mutual funds has been cut nearly in half, even as the services shareholders receive have greatly expanded.

Second, what explains this trend? Put simply, competition. It turns out that the SEC is not the only regulator of our industry. Market forces are at least as tough.

A number of specific factors underlie the dramatic decline in the costs shareholders incur. These include the wide availability of information on fees, the increased focus of shareholders on good performance and low expense ratios, the wide range of funds available, the emergence of no-load funds and fund supermarkets, the role of the Internet in fostering increased competition and easier price comparisons, and other factors.

For example, the median front-end load on equity funds dropped from 8.5 percent in 1980 to 5.5 percent in 2004. Load waivers have also become commonplace. And economies of scale have helped reduce the expense ratios of many individual funds as they have grown.

Our fund governance system undoubtedly has played a part as well. As directors, you are required to devote continuing attention to this issue as to many others.

The Role of the ICI

The growth of the industry, and the emergence of funds as the main investment vehicle for millions of average investors, places great responsibility upon all our shoulders. We are and should be held to high standards of accountability. As I remarked soon after

becoming the Institute's President, we should not only expect close scrutiny, but understand that our size and importance demand it. That goes for the Institute and its activities and policy recommendations as well.

With this in mind, beginning in October 2005, I will be providing the boards of all the Institute's member funds a brief quarterly report of ICI's recent activities. My first report, a copy of which is available outside to all conference attendees, highlighted the following:

- the efforts of ICI and ICI Mutual Insurance Co. to help mutual funds respond to the needs of shareholders displaced by Hurricane Katrina;
- the introduction of the [GROWTH Act](#) in the Senate and the growing bipartisan support for this important legislation, which would allow long-term mutual fund investors who automatically reinvest capital gain distributions to defer taxes until they sell their shares;
- the launch of a new ICI website, www.FundingYourFuture.org, which was designed as a tool for investor education and advocacy;
- my letter to SEC Chairman Chris Cox, encouraging strong efforts by the SEC to preserve the confidentiality of mutual fund trading information and thereby protect fund investors; and
- our ongoing work to assist member funds in complying with the recommendations of the [NASD's Breakpoints Task Force](#), to ensure that investors receive appropriate breakpoint discounts when they purchase shares from brokers.

The third quarter of 2005 was not atypical. We were moving forward on many fronts, responding to exigent circumstances (as we did with Y2K and 9-11), working closely with the Congress and SEC, attending to complex operations issues, and reaching out to the many constituencies interested in mutual fund investing.

I hope that independent directors will find quarterly highlights of this kind to be useful and informative in understanding the role the ICI plays today on behalf of mutual funds and the significance of that role to investors. It is a role unique to ICI, one we have sustained for many years, and one of which I am most proud. In the months and years ahead, I look forward to continuing a close and candid dialogue with independent fund directors, and I welcome any comments, questions, or recommendations you may have.

Thank you for participating in this important conference. Thank you for your attention, and most of all for your diligent efforts on behalf of your funds and their shareholders.