

## ICI VIEWPOINTS

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## Industry Leaders Reflect on Serving Investors in an Evolving World

By Christina Kilroy

Speaking on the Leadership Panel held Wednesday, May 21, at ICI's General Membership Meeting (GMM), fund industry leaders agreed that challenges as well as opportunities abound for their businesses in today's complex world. Ed Bernard, vice chairman of T. Rowe Price Group, led the discussion, which covered a wide range of issues affecting the industry and examined how it can meet the needs of fund investors in a rapidly changing environment.

### Examining Alternatives

"Over decades," Bernard noted, "the industry has a long and successful history of innovation and solutions to meet client needs." In the most recent decade, he observed, there has been notable growth in the asset class known as "alternative investments."

Though the term broadly covers investments that have a low correlation to standard asset classes, Bill Glavin, chairman and CEO of OppenheimerFunds, expressed concern that bringing these types of investments into the mainstream causes them to lose the benefit of uncorrelated return. And although "some of the strategies can probably be scaled [to a mass audience]," Dana Emery, president and CEO of Dodge and Cox, cautioned that "a lot of them are niche-oriented."

Despite these challenges and the potential complexities of these types of products, the panelists agreed that alternative investments present an opportunity for the fund industry. Developing products that bring this asset class under the regulatory umbrella of the Investment Company Act of 1940—with the investor benefits that the Act provides, including daily pricing, liquidity, and fee transparency—"is a wonderful thing," said Marty Flanagan, president and CEO of Invesco Ltd.

But the real question, Flanagan said, is, "What are we trying to do for our clients?" Alternatives provide an opportunity to offer investors better results, he said. "The broader you can diversify your portfolio," the more you increase "the likelihood of increasing returns with lower risk."

Daria Foster, managing partner at Lord, Abnett & Co., also stressed the importance of meeting clients' needs. She agreed that the fund industry must focus on providing investment products that fit into investors' desired asset allocations, and should provide education around these types of products: "Our responsibility is to make sure that investors understand what this product is designed to do."

### The Costs of Increased Regulation

"The world is getting more complex everywhere," Flanagan told the audience. The panelists stressed that, with regulatory initiatives at home and abroad making fund distribution and investing ever more challenging, it's more important than ever for firms to keep abreast of regulatory trends and changes around the world. "It's critical to have a global point of view, whether you decide to distribute [overseas] or not," Foster said.

The conversation then turned to regulatory initiatives in the United States, specifically the review of asset managers by the Financial Stability Oversight Council (FSOC) as possible sources of systemic risk. The panelists questioned what would be achieved by additional oversight in the already highly regulated fund industry, especially "prudential regulation" by the Federal Reserve, which may fit the banking industry but does not address the structural differences of the asset management industry.

"I think it's not well-founded in the sense that asset managers are really agents for their clients—they're not principals—and that's a

huge distinction,” said Dana Emery, president and CEO of Dodge & Cox. “Where is the risk? Obviously, ’40 Act funds have limits on leverage, [they have] diversification, daily valuation. When you think of those factors, you don’t have the same types of risk [that] you have inherent in a ten-times-levered bank.”

Even if only a few funds are designated as systemically important financial institutions, or SIFIs, “it will distort the industry,” argued Bernard. Glavin agreed, adding that “This issue will affect every firm in the industry, regardless of how big or how small you are.” Because asset managers act as agents in the markets on their clients’ behalf, he said, the costs of additional regulation “ultimately comes from the shareholders of the funds. That’s a huge burden that’s going to be placed on all shareholders in this industry,” not just shareholders in a SIFI-designated fund.

## Serving the Retirees of the Future

The issue of retirement is another that presents challenges and opportunities to the industry. Acknowledging the importance of Social Security in providing retirement income, Flanagan stressed the fund industry’s important role in helping American save for retirement. Bernard expanded on this, saying, “The government has to protect the soundness of Social Security, but then play a key role in ensuring that there are good incentives and rules and regulations in place to have a strong private saving system.”

The panelists agreed that work remains to be done in the space. For example, increasing saving rates and participant education are key to improving retirement outcomes. Flanagan stressed the need for straightforward communication, noting that investors are sometimes overwhelmed by too many options. He pointed out that packaged retirement products, which are designed to help investors choose an investment vehicle by asking them to answer simple questions about risk tolerance or time horizons, are attracting significant money because they make “sense to investors. They can make decisions in that language.”

But even with all the talk in the industry “about getting people *to* retirement,” Emery said, the industry needs to focus on “getting them *through* retirement” by helping them understand the risks involved in retirement planning, such as longevity risk and inflation risk.

For all the complexities involved in today’s financial markets, Flanagan said, the fund industry must never stray from its core values. “It’s an obligation for us to do the best we can on behalf of the people who we manage money for,” he stressed. “We’re fiduciaries, and that’s got to be our focus.”

Christina Kilroy is the Vice President of the ICI Education Foundation.