First Annual Mutual Funds Leadership Dinner: Remarks by ICI Chairman

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Remarks of
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Thanks to each of you for taking the time to attend this, the Investment Company Institute's first Mutual Fund Leadership Dinner. The key word tonight is "leadership," because that is what we have here. We are honored to have nearly 40 distinguished Members of Congress attending tonight, including Speaker Denny Hastert who has been very generous with his time and insightful with his comments. I also want to thank Senator Sarbanes for his insights at our Policy Forum earlier this afternoon. While this magnificent Library puts us on Congress's home turf, let me likewise thank Securities and Exchange Commission Chairman Bill Donaldson, other members and staff of the Commission, and senior administration officials, including leaders of the Departments of Treasury and Labor.

Fund leadership is also here in force: including our Institute Board Members (representing more than 95 percent of our country's mutual fund assets), members of the Independent Directors Council, and other senior executives and board leaders from around the country.

This gathering signals our determination to strengthen lines of communication between the leadership of America's mutual funds and senior policymakers throughout government. All here are conscious of the high trust placed in mutual funds by tens of millions of shareholders and the central role that funds play in the achievement of their financial goals. It is safe to say that effective dialogue between leaders of mutual funds and government policymakers has never been more important than it is today.

Indeed, I am sure we can all agree that we have just come through an incredible period -- for the markets and for mutual funds. Let's consider just a few metrics. At the height of the speculative stock market bubble (1998 and 1999) the S&P 500 rose 56 percent and the NASDAQ Composite Index an unbelievable 160 percent. But in the three years following, the S&P fell 38 percent and the NASDAQ Index plummeted 66 percent. Then, in '03, the markets began to recover, and overall, for the seven-year period, those indices are up about 40 percent -- quite a roller coaster ride with some of the most dramatic market volatility we have seen in many decades.

Moreover, this has been an era also characterized by major challenges -- a technology revolution, corporate restructurings, ethical lapses, growth pains of a global economy, restructuring of our capital markets.

And throughout this period, mutual funds have not only survived but thrived as investors sought professional assistance in managing their savings. To put a metric on this, in just the last ten years, mutual fund assets have nearly tripled -- from less than $3 trillion in 1995 to over $8 trillion today.

There is a reason for this growth. Quite simply, throughout this period, mutual funds have continued to provide the vast majority of individual investors the most efficient and effective access to securities markets they can achieve. And, generally speaking, funds have successfully guided most investors through these rapidly changing markets.

How can we build on this strength? Importantly, mutual fund managers must continue to be accountable; act in investors' interests; conduct their activities with integrity; and continue to be the most transparent of any financial service.

But at the same time, funds must remain competitive, dynamic, and responsive to investor needs. And -- leadership being so critical -- fund managers must be able to attract the best people in the competition for talent. There are 92 million mutual fund investors. They deserve to have “the best and the brightest” managing their investments.

Make no mistake, the past two years have been challenging for all of us involved in the management of funds -- both from an investment and business point of view. The problems and the fall-out from those events once again demonstrated two key factors of fund management -- the fragility of the bond of trust between an investor and his or her fund, and the importance of maintaining a fiduciary culture in our organizations.

In case it needs to be repeated one more time, let me say as clearly as I can: none of us who serve fund investors countenances unethical behavior. Our business is only as good as its reputation, and we are determined to maintain and build respect for both -- for the sake of our investors and our business.

We have no product to sell. Our business depends on the willingness of investors to turn their hard-earned money over to us for management. If any of us gives investors reason not to trust us, they will take their assets elsewhere. It really is as simple as that. Therefore, in the long run, we will prosper only if our investors see value in our services.

But while the misbehavior of a few is richly deserving of condemnation, it is also important to keep a sense of perspective when assessing the industry as a whole.

Since the number of fund managers drawn into these problems was relatively small and the actual dollar damages to investors were relatively limited in scope -- compared, for example, to WorldCom alone which cost investors some $200 billion -- it was heartening to see that the industry response -- and that of the regulators -- was so dramatic.

Frankly, this told me two things: First, even in a business that has a long history of conducting its affairs with integrity, we are -- sadly -- not immune to excesses and hubris. And second, the immediate and clear response of fund leaders, who urged the strengthening of regulations in the areas of concern, reassures me that fund managers are committed to doing the right thing.

Fortunately for all of us, investors recognized this latter fact as well. Make no mistake about it, for those fund managers that found themselves in the headlines, the damages imposed by the marketplace far exceeded the regulatory penalties. But investors appeared to be quite discriminating: They did not spread the blame beyond those who were culpable -- and they even seemed to sort through which offenses were more serious and, not incidentally, also took into account how the funds involved had been performing.

Most importantly, confidence in mutual funds generally, as an investment vehicle, was not shaken. From September 2003 (when the first problems came to light) to September 2004, stock and bond funds had net inflows of nearly $230 billion. That is empirical evidence from the marketplace that investor trust in mutual funds remains solid.

Of course, one doesn’t get the confidence of investors by asking for it -- it has to be earned over time. Because mutual funds have earned investor confidence over many decades, that credibility has served them well during this period of intense scrutiny and recovery from the headlines.

For the last 18 months, Congress, regulators, and industry members have all worked together to help assure investors that those problems were not systemic, that problems were being addressed -- and that the guardians and overseers of the business have reacted responsibly.

I believe we are now at a turning point. It is time to move on to the next chapter of the evolution of mutual funds. We have to build on the regulatory safeguards that have been put in place and again focus on ensuring that Americans have opportunities to build for their financial future.

We also have to fight an impulse all too common in this town. More regulation -- in all industries -- is the natural political and regulatory response to business excesses and changing standards of practice. That is one of the prices that business pays when it wanders ethically.

In the case of mutual funds, though, there is an important, interested person whom we should not forget -- the Investor. So, thinking about the investor -- who is in this case the center of our universe -- I suggest that as we examine prospective regulatory changes and those already in place, we apply a simple test that asks several key questions:

- How do the new rules affect the investor?
- Do they enhance fund performance? After all, that is why investors buy fund shares.
- Do they provide information that investors will find useful in making investment decisions?

- Is their cost worth the benefit to investors?
- Do the rules enhance investor confidence that they are being dealt with fairly?

To this last point, let me note that I think the Compliance requirements -- Chief Compliance Officer, policies and procedures, regular reports to Fund Directors -- will for investors prove to be the most important reform passed by the SEC and it could serve as a model for all corporations.

We should acknowledge that investors expect things like compliance, governance, and controls to be effective. But they care about these things as a means, not an end. They don't want to know how such processes are done, they just want assurances that they are being done. Because the end for investors is the fund's investment return. So if complex disclosure requirements undermine their understanding of their investment -- or even worse, needlessly reduce their fund's investment return -- then all of us have an obligation to try to strike a better cost/benefit balance.

Historically, it has been in the interest of mutual funds and their managers to support regulatory measures that seek to protect investors. In fact, in large part the success of mutual funds has stemmed from the sound regulatory structure and policies under which they have operated. This regulatory scheme -- coupled with the tremendous transparency funds offer compared to other financial services -- have helped drive investor acceptance of funds.

Toward these ends, our industry -- through the Institute -- has a long history of support for protecting investors. We have worked closely with regulators since the 1940's to the benefit of investors.

Look at it this way: How many other industries that you know would consistently tout their regulatory scheme as one of the key reasons for their prosperity? To illustrate my point, consider this -- Just during my career, SEC leadership on more than one occasion has raised with the Institute the possibility of the ICI becoming a self-regulatory organization for funds. For some valid reasons, that has not appeared to be practical from the industry's point of view. But it is hard to think of another so-called trade association to whom industry regulators would make that kind of proposal.

Mutual funds and their regulators have had a relationship that has been beneficial for both investors and fund managers -- and it has been an appropriate one. Recently, we have seen it denigrated. Some in the media have confused being cooperative with being "cozy." And the actions of a few, coupled with media frenzy, have put pressure on government regulators to favor enforcement over regulation.

The fact is, the SEC, the NASD, and the industry have been able to achieve more for investors by pursuing a constructive relationship than a confrontational one. I strongly believe investors will best be served by a return to that cooperative state as soon as possible.

And as we work together -- fund managers, fund directors, regulators, and legislators -- to further improve the environment for mutual funds, we also need to recognize how the ethical environment has changed.

A new book titled: The New Ethics -- A Guided Tour of the 21st Century Moral Landscape, addresses this issue. The author, Anita Allen, a professor of law and philosophy at the University of Pennsylvania, comments on our current times.

She writes:

"The part of ethical living that is supposed to be easy -- namely, following simple, familiar rules -- turns out not be to so straightforward. Indeed, good choices of any kind are not easy, but we can improve the picture with well-designed moral education, disciplined workplace ethics and more effectively regulated businesses, professions and industries."

With those comments, I think Dr. Allen offers us a road map to deal with this increasingly complex ethical world in which we operate:

- Within our organizations, we must build cultures that encourage and reward employees for doing the right thing when there are no simple rules.
- In turn, the regulators have to provide guidelines that are understandable and can be applied by people who are trying to do the right thing.
- And I should note that a strong code of ethics and an effective set of compliance policies and procedures represent an important start to the process of what Dr. Allen calls "ethical living."

What is my bottom line for you?

Simply this: Never has it been more important for Americans to strengthen their own long-term financial capacity. Regardless of how one feels about the issues in the current Social Security debate, I think it is tremendously beneficial to have a public discussion that highlights to so many Americans the importance of retirement security. It has taken an appropriate place on the top of the public agenda, with Social Security at the center.

The future long-term financing challenges of our government Social Security program highlight the need to strengthen the other two legs of the retirement stool -- individual savings and employer savings plans. For example, deferring taxation of mutual fund distributions that are automatically reinvested in the same fund, until the shares are sold, would provide a powerful and immediate incentive for private savings and investment for retirement. We can also expand opportunities for employer plans by automatically enrolling employees, providing more effective investment options, and eliminating restrictions on investment advice.

Ultimately, one of the best solutions to the growing pressures on Social Security is to reduce retirees' dependence on it. Most of all, to ensure that mutual funds can continue to be as effective as possible in contributing to the strength of that third leg, we need cooperation between the industry and policy-makers.

For fund leaders, tonight is an opportunity to reassert our commitment to ensuring trust in those of us who have been given important responsibility for investor monies. No one has a better understanding of the importance of investor trust than those of us responsible for funds. A few took that for granted -- and paid a steep price. Fortunately, the vast majority of fund managers either didn't need the lesson -- or were able to learn it vicariously. And most of those who were damaged have responded appropriately and are working hard to regain the confidence of investors.

And I also believe that many of those intermediaries who assist investors with their fund decisions have learned from this process as well -- all to the benefit of their clients.

That is what we are all trying to achieve. That is where our long-term interests converge. And we know it is working in this country because American mutual funds are the least expensive and most transparent to investors in the world -- by a wide margin in many cases.

Our goal, then, is to ensure

- That funds in this country remain an attractive, low-cost vehicle for investors to participate in our securities markets;
- That investors continue to have convenient access and a wide range of fund choices to meet their investing needs;
- That investors have the information they need to make reasonable investment choices; and
- Above all, that investors can continue to trust those of us who manage and oversee their investments to act in a prudent and responsible way with their money.

That is our goal, as I know it is yours. Tonight, as leaders in both the private sector and in public service, we want to reaffirm our commitment to serve the shareholder -- and continue to contribute to the growth that our nation depends upon for prosperity and progress.

Thank you.
