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ICI General Counsel Remarks at the 1998 Mutual Funds Disclosure Reform Conference

Welcoming Address

by Craig S. Tyle

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Good morning and welcome to the ICI's special conference on the SEC's new mutual fund disclosure rules. My name is Craig Tyle and I am General Counsel of the Investment Company Institute. I'd like to thank everyone for coming here today.

Today's conference will provide an in-depth review of three recently adopted rule changes that will significantly alter the way that mutual funds communicate with investors—the [Plain English rule](#), the [revisions to the registration form](#) for mutual funds, Form N-1A, and the adoption of a new disclosure document, the fund profile.

Each of these changes is highly significant. Together, they represent what are perhaps the most fundamental revisions to the disclosure regime for mutual funds since the enactment of the Securities Act in 1933.

I'd like to spend just a few minutes going over what I believe are some of the key features of these rule changes, and what implications they may have for future developments.

Listening to Investors

First, the rule changes are notable because they are reflective of what actual investors really want. The SEC made a concerted effort to obtain the views of the investing public on the proposals. For example, over 200 individual investors submitted comments on the proposed fund profile. And over half of the comment letters submitted on the Form N-1A amendments came from individual investors. In both cases, the vast majority of those investors supported the proposed changes.

The mutual fund industry also actively sought out the views of the investing public. Many fund groups already have revamped their prospectuses, some after conducting research with focus groups. The Institute conducted two extensive investor surveys—one [survey on risk disclosure](#) and the other survey on the fund profile. The first survey demonstrated that investors wanted simplified narrative risk disclosure and visual presentations of a fund's volatility, and were not interested in, and could not understand, complex numerical risk formulas. The second survey showed that investors wanted the option to make investment decisions on the basis of a simplified document like the profile.

Of course, research like this has its limits, and I would not want to suggest that every regulatory proposal, some of which may involve complex matters of law and economics, should be decided on this basis. But especially when it comes to matters like disclosure, the SEC should at least be fully informed of the views of those to whom the disclosures will be directed.

Tailoring the Rules

A second key element of the new rules is that they acknowledge that one size does not fit all. Information that may be important to an institutional investor may not be relevant to a retail investor and may actually serve to obscure the information that he or she finds most useful. Of course, this was the premise behind the adoption of Form N-1A, and the two-part prospectus, in 1983. Last month's amendments to Form N-1A became necessary, in part, because the 1983 reforms did not go far enough, and prospectuses still were burdened with technical and legalistic disclosure that was not meaningful to most investors. The adoption of the profile, which gives investors yet another option, takes this one step farther. In addition, the SEC permitted both the profile and full prospectus to be tailored to the defined contribution retirement market. All of these steps recognize that different investors have different needs, and that the disclosure rules can provide the necessary flexibility to take account of those different needs.

Making Comparisons

Third, the new disclosure rules will enhance the ability of investors to make comparisons among different mutual funds. This has long been an objective of the Commission's; the adoption of the fee table and the performance advertising rules in 1988 are examples of this. The fund profile contains nine specified items in a standardized format, and is designed to facilitate comparisons. The full prospectus will now contain a standardized "risk/return" summary, which will incorporate several elements of the profile. And, the SEC was quite clear in its adopting releases that funds should focus on features that distinguish them from other funds, rather than on elements common to all funds, in drafting prospectuses and profiles.

Assessing Risk

A fourth important feature of the new rules is their approach to risk disclosure. The bar chart that shows the volatility of a fund's returns is an innovative feature that responds to a demand for more information in this area, and presents it in a manner that all investors can understand. The shift in focus of narrative risk disclosure from specific securities to the fund as a whole also should result in more meaningful disclosure to investors. In making this change, the SEC recognized that mutual fund investors are not primarily buying a package of securities; rather, they are buying a service—professional money management. The SEC also wisely avoided the temptation to seek short-cuts, such as trying to boil down risk disclosure to a single number.

Going Forward

Those are just some of the important elements of the new rules. What implications do they have going forward?

Shareholder Reports

Perhaps the most immediate implication is the guidance the new rules provide for future SEC disclosure initiatives. The Commission is expected to propose revisions to shareholder reports in the near future. The SEC can use that rulemaking to further the goals of prospectus reform—for example, by moving some information from the prospectus to the annual report. It should also take the opportunity to replace the lengthy list of portfolio holdings in shareholder reports with more meaningful disclosure about the fund's investments. Of course, the complete list should still be available upon request. But, as I noted earlier, one of the key features of the new disclosure rules is their rejection of a one-size-fits-all model. Thus, detailed information that may be of interest to some investors is not necessarily important to all investors. And, query how important is a snapshot of a fund's portfolio to an investor that is purchasing investment advice, as opposed to a package of individual securities.

Retirement Plans

A second implication of the new rules is that they show that it is possible to develop good disclosure standards for retail investors, and that these standards can be tailored for important groups of investors, such as participants in defined contribution retirement plans. The Department of Labor should take note of this. While participants in plans that offer mutual funds will receive the SEC-required disclosures, at least if those plans avail themselves of the safe harbor under Section 404(c) of ERISA, it must be remembered that mutual funds currently account for less than 40% of the 401(k) market. The Department should require all investment options to provide comparable disclosure.

Judicial Notice

Third, our courts need to take judicial notice of these rule changes. Many in the industry remain concerned over decisions that imply that unless extensive, detailed disclosures are set forth in fund prospectuses, funds will be held liable under the securities laws. Such a result turns the Securities Act on its head. The purpose of the 1933 Act was to ensure that investors are informed about the securities they invest in; the liability provisions are there to ensure that the disclosure provided to them is accurate and complete. But

when concerns over liability make it impossible to provide information in a manner that an investor can understand, the entire objective has been defeated. Courts need to interpret the Securities Act so that it accommodates simplified, Plain English disclosure. The SEC needs to step in when necessary and urge them to do so.

National Standards

Fourth, the new rules underscore the need for national standards. It was less than two years ago that the Institute held another special one-day conference, on the National Securities Markets Improvement Act of 1996, which pre-empted state regulation of mutual funds. Does anyone seriously believe that either the fund profile or the simplified full prospectus would have been accomplished if they remained subject to regulation by 50 state securities regulators? Currently, Congress is considering legislation that would apply to state causes of action the same principles that were applied to federal causes of action in the 1995 legislation on securities litigation. There, as here, the objective of the 1995 legislation will be frustrated unless a single national standard is applied.

A Higher Standard

Finally, the SEC needs to be vigilant if the 1998 reforms are to be successful. In particular, the Commission must resist efforts to incorporate into the prospectus disclosure on whatever happens to be the hot topic of the day. Indeed, with the ink barely dry on the new rules, we've seen calls for new disclosure on investments by portfolio managers, on how the 1940 Act governs the rights of fund shareholders, and on all the details of a fund's Year 2000 compliance program. All of this information is probably of interest to someone. But the new rules contemplate a higher standard to govern what is included in a fund prospectus—one that I hope the SEC will adhere to.

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Of course, while it is interesting to speculate on the future, most of us are still grappling with the present—in particular, what must funds do in response to the new rules? Hopefully, we will be able to address that question at today's conference. We've assembled an outstanding group of moderators and speakers who will address each of the three major new rules—the N-1A amendments, the Plain English rules, and the fund profile. We've also set aside time to answer your specific questions.

I'd like to thank all of our panelists for their participation, especially on such short notice, and give special thanks to our panelists from the SEC staff. I'd also like to thank Sue Burgess from the ICI staff for organizing the conference.

It is now my pleasure to introduce Barry Barbash, the Director of the Division of Investment Management. Barry does not have a prepared speech this morning, but he has agreed to kick off the conference by giving a few informal remarks. Please join me in welcoming Barry Barbash.