Sunlight Through the Clouds: Emerging from the Financial Storm

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## Opening Remarks

## Mutual Funds and Investment Management Conference

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Thank you, Jack [Lockridge, executive director, Federal Bar Association], for that introduction, and thanks to you, the Federal Bar Association, and Tom Lemke for your valuable assistance in assembling another outstanding program.

Good morning to all of you, and thank you for joining us. I see many familiar faces here, and some new ones as well. Whether you're a newcomer or a veteran, you'll find there's a lot to learn and even more importantly, a lot to benefit from in the program we've put together for you.

I'm a veteran—I've been coming to this conference for about a decade, in private practice and at ICI.

And I've always wondered what it's like to stand at this podium and look out at this audience of expert, skilled, astute professionals, drawn together by their deep knowledge and interest in the fund industry.

Well, now I'm here … and let me tell you—it's kind of daunting.

Daunting even under the best of circumstances.

But particularly so this year.

Because when I think about this conference, I think about answers.

This is where I came to figure out my workload for the coming year … to hear the best intelligence on what regulators were thinking … to talk with top professionals … to think through the challenges we face as an industry.

Each year, I left with greater clarity about how regulators and market forces would shape our industry's course over the next 12 months.

Well, this year's conference will bring you the best intelligence you can get. We're using technology to overcome the SEC's current travel restrictions. In a few minutes, Eileen Rominger, the new Director of the Division of Investment Management, will introduce herself by satellite link.

We'll also hear from the SEC's Jennifer McHugh and Bob Plaze through the magic of electronics. And we're honored to have in

person top officials from the Treasury's Office of Tax Policy, the Department of Labor, and FINRA.

Our program also should give you plenty of thoughtful insights from the best in our profession on our industry's challenges. We've added new panels on navigating the swaps market … the new face of fixed income … and Trading and Market Structure 101, a primer for fund lawyers on the issues your trading desks face.

And because regulators are increasingly looking across borders and our business is more and more global, we'll hear from international experts on the challenges they face as well—including a Q-and-A discussion with Dan Waters from the UK Financial Services Authority.

What I can't promise you is certainty.

Many of you were with us in Phoenix in March 2008, when Bear Stearns collapsed just before this conference started. Since then, our financial world has been in turmoil.

I don't need to remind you of the events, the seemingly endless loop of crisis and response that we have endured since then—who wants to remember all that?

But clearly, this global financial crisis was a very real stress test for the funds you counsel.

We've come a long way in the past three years. We rallied together, as an industry, to address the threats and find ways to continue to serve our shareholders, under enormous strains and pressures.

As advisers to the industry, the men and women in this room were on the front lines of these efforts. Your advice, your cooperation, and your collegiality were crucial to helping our companies weather that storm.

And we have definitely seen progress.

The financial markets have regained their footing. The Federal Reserve has significantly reduced its emergency facilities. The SEC has adopted its amendments to Rule 2a-7 for money market funds. And Congress has weighed in with the passage last July of the Dodd-Frank Act.

But certainty about our future? That's still a distant dream.

Think about it—we face a host of questions that will affect our businesses for years to come.

Which financial institutions are going to be deemed "systemically significant"? The new Financial Stability Oversight Council—or "FSOC"—is aiming soon to start designating businesses outside of the banking world as SIFIs—"systemically important financial institutions." We've been through two rounds of comment on how the FSOC will make these designations, and there's still not much that we can say for sure about which companies will be designated. Nor has the Fed developed the standards it will apply to SIFIs.

Uncertainty.

What's going to happen with money market funds? The President's Working Group has issued its Report on Money Market Fund Reform Options. ICI is pursuing its proposal for a liquidity facility—a private-sector solution, created and financed by prime money market funds and their sponsors. We believe that such a facility could provide the liquidity backstop that funds may need if we ever again see market conditions like those of September 2008. We've presented the blueprint, in great detail, to the SEC, the Treasury, and the Federal Reserve—and now we're still in wait-and-see mode.

No certainty there.

How will your investment advisory firms compensate their executives? The SEC has joined the FDIC with a sweeping proposal that could govern executive compensation for any firm with $1 billion or more in assets on its balance sheet—in other words, much of the fund industry.

The centerpiece of this proposal is a rule that would prohibit "excessive compensation" that encourages "inappropriate risks."

ICI hasn't yet written its formal comment … but I would note that this is the sort of standard that's easier to enforce in hindsight than to implement in advance.

More uncertainty.

What's going to happen to your internal compliance programs if the SEC adopts its proposed whistleblower program? Dodd-Frank

required the SEC and the Commodity Futures Trading Commission to create bounty programs to reward informants who report violations of securities and commodities regulations.

This provision has certainly brought out the entrepreneurial urge in some of our legal brethren … perhaps you've seen the new website, "SEC Snitch-dot-Com," touting the multi-million-dollar rewards that whistleblowers could have collected in recent SEC settlements had this program been in place.

When the SEC issued its proposal for the whistleblower program, its discussion repeatedly acknowledged the importance of internal compliance programs. Unfortunately, there is nothing in the rule's actual provisions that even mentions internal compliance programs. The CFTC rule follows the same path.

As counsel to funds and as compliance officers, you know the investment and effort that your firms have put into creating effective internal compliance programs, to the great benefit of shareholders.

But how can you maintain that strong compliance program if your employees know that the SEC is dangling a rich reward for those who bypass internal reporting? We'll address that later today during our panel on "The Regulatory Revolution"—but I can't promise you any answers.

How will regulation change the distribution landscape over the next few years? There is very little certainty as to what fund distribution will look like five years from now. Last year, the SEC proposed to rescind Rule 12b-1 and replace it with an entirely new distribution framework. That proposal that drew more than 2,000 comment letters—the vast majority of which were overwhelmingly negative.

Now, the debate over applying a fiduciary duty to broker-dealers is in full swing at the SEC and the Department of Labor. The only thing we know for certain is that there will be change.

Could I could go on? Oh, yeah.

There's the Volcker Rule, and there's swaps and derivatives. There are even questions about how many regulators we'll be answering to—especially since the CFTC seems to have taken a new interest in mutual funds. You may think that you're advising a mutual fund—but to the CFTC, it's a commodity pool operator. Maybe it's both? Can you even comply with both regimes at the same time? Talk about uncertainty.

With this tumult comes frustration—particularly when regulators seek to impose rules that ignore basic facts about the structure, operation, and regulation of our funds.

Take the SEC's proposed rules for proxy access, now on hold due to a challenge filed by the U.S. Chamber of Commerce and Business Roundtable. ICI and the Independent Directors Council have joined that case as friends of the court, because the rule imposes the same requirements on funds' unitary and cluster boards as it does on the boards of operating companies—despite their fundamental differences. We're looking forward to the oral arguments next month in the D.C. Circuit Court of Appeals on that case.

The SEC's amendment to its "pay-to-play" rules offers another example. The detailed reporting and record keeping required by the rule puts fund advisers on the hook for account information that they don't control and can't get. Unless the SEC or FINRA creates similar reporting requirements for brokers and other intermediaries that operate omnibus accounts, fund advisers will not be able to comply with the new pay-to-play rules, through no fault of their own.

Well—that's a lot of uncertainty, and a lot of concerns.

You get the picture: life in the trenches of today's fund industry is pretty challenging.

So let me turn now to some happier prospects—and yes, there are a few—by discussing what we do know at this point, three years into the financial crisis and its aftermath.

First—we know that regulators by and large are taking a thoughtful approach to their rulemaking duties—despite their crushing workload.

Think about it: Dodd-Frank laid down markers for more than 250 new studies, regulations, and reports—and many of them are due by the end of this year, just 18 months after the law's passage. Faced with such heavy demands, the SEC and other agencies could have panicked and started rushing proposals out the door, all on 30-day comment periods.

Fortunately, they haven't. While we have serious issues with some of the regulations they've proposed, we're glad to see that the agencies generally are offering longer comment periods and are putting their priority on getting the rules right, not on meeting the due

dates. That’s a hopeful sign.

We also know that the debate on key issues has been robust. On such important questions as designation of systemically important financial institutions, commenters from a wide range of interests have weighed in with their views and analysis about how to identify and evaluate financial risk. Academic papers and conferences have been devoted to broadening the debate on these topics.

That’s how the policymaking process should work—another cause for hope.

We know that America’s lawmakers continue to believe in our funds.

Yes, we have had to work hard on Capitol Hill, on a range of issues. But throughout the crisis, we made it clear that our funds served Main Street investors—and that resonated with Congress.

How else do you explain the passage of the Regulated Investment Company Modernization Act—fondly known as “RIC Mod”—tax legislation supported and passed by both parties in the midst of one of the most bitterly partisan congressional sessions in memory?

And one more key thing we know.

Even though we’re living in an uncomfortable state of uncertainty, our investors have maintained their confidence in funds.

We’ve seen that confidence clearly expressed in the debate over money market funds. Groups representing businesses, government, financial services, and consumers have stepped forward to register their support for the fundamental aspects of money market funds, particularly the stable $1.00 net asset value. This widespread endorsement has supported our efforts to avoid proposals that would seriously undermine the value of money market funds for fund shareholders.

We see this confidence in the behavior of households, who continue to turn to funds to help them meet their financial goals. From 2008 through 2010—despite the worst financial crisis since the 1930s—households’ net purchases of funds totaled $900 billion. Put another way, 85 cents out every dollar that households invested in financial assets, on net, flowed into mutual funds, exchange-traded funds, variable annuities, and closed-end funds.

Individual investors recognize the strength of our model.

We saw the same confidence in the behavior of retirement savers. Since 2008, ICI has tracked the behavior of a large sample of participants in defined contribution plans—more than 22 million accounts.

When we started, the conventional wisdom was that 401(k) participants were rushing for the exits and draining their accounts. What we’ve found has been just the opposite. Every year, more than 95 percent of 401(k) savers have kept contributing and avoided withdrawals. Only one in six has changed asset allocations.

Retirement savers have stayed the course.

As ICI’s chairman, Ed Bernard of T. Rowe Price, likes to say—the people who invest are a lot calmer than the people who just write about investing.

Clearly, investors have faith that the foundations of our industry remain strong.

And that brings me to some things that I can say with absolute certainty—even in these times of questions and doubts.

The model of fund investing that is enshrined in the 1940 Act—transparent, diversified, with limited leverage, and subject to strict pricing disciplines—demonstrated its worth during the financial crisis, serving both funds and their shareholders well.

And our fiduciary culture must remain alive and well—and at the heart of our enterprise. I challenge each and every one of you to keep our shareholders foremost in your minds as you help them achieve their long-term financial goals.

Shareholders must come first.

Our industry success depends upon the trust of our investors, and we must earn that trust every single day.

As counselors to our funds, you are central to the mission of maintaining that culture of trust. You, along with your colleagues, must constantly ask, “What is best for our shareholders?”

So we’ll face many questions and concerns in the months ahead. We won’t have all the answers—either here in the next three days or when we go back to our offices.

But we always have the bedrock belief in our mission and our service to investors. And that, together with the faith they entrust in us, will ensure a strong future for us all.

Thank you.

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