

2000 Mutual Funds & Investment Management Conference: Keynote Address

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Good morning. I'm pleased to join Paul Roye, the Director of the SEC's Division of Investment Management, in delivering keynote remarks today. We are most fortunate to have someone with Paul's judgment and experience leading the Division. He can count on the continued cooperation of the investment management industry in the times ahead.

This is a year of anniversaries. 2000 marks the sixtieth anniversary of the Investment Company Act. This is the thirty-fifth annual meeting of this conference. Please join me in a round of applause for its founders, Scott Hodes and Murray Simpson.

What a triumph these years have been. Before mutual funds, average Americans were on the outside looking in as far as the securities markets were concerned. Mutual funds changed all that, allowing middle-income America to participate in our nation's economic growth as never before.

Today, over 80 million individual shareholders own mutual funds, nearly one in two households. Our industry opened the capital markets to all investors, and we have done so without scandal, without government bailouts, without betraying the trust and confidence of our shareholders.

Vince Lombardi of the Green Bay Packers once observed: "Individual commitment to a group effort—that is what makes a team work, a company work, a society work, a civilization work."

I often am asked why our industry is so successful. Many factors play their part. But I am convinced that the most enduring factor has been our willingness to work together to ensure that laws, regulations, and voluntary business practices protect and serve our shareholders.

In the 1930s, we supported the SEC and the Congress as they worked to put in place the core protections of the Investment Company Act. Daily pricing, prohibitions on affiliated transactions, independent directors, full disclosure—these high fiduciary standards, unique to our industry—likely would not exist had our industry chosen to oppose reform, rather than to work together in support of the Investment Company Act.

Our commitment to our shareholders has continued throughout our history. Time and again, we have joined together to educate our shareholders, to broaden their investment opportunities, and to keep the Investment Company Act's successful system of regulation in step with investors' changing needs. We must continue this tradition. Our success carries great responsibility—to our shareholders and to the unique fiduciary culture that we have inherited.

While we constantly strive to comply with the letter of the laws and regulations that govern our activities, we also know that to serve our shareholders we must always live up to the spirit of those laws and regulations. For this reason, I'd like to take a moment to talk about investor expectations, and our continuing effort to do what we can to make sure they reflect time-tested and enduring principles.

All of us know individual investors whose expectations about the future performance of the market have grown well beyond what history and experience suggest can be reasonably satisfied. Many different factors have contributed to this phenomenon: a bull market of unprecedented duration; newsletters and websites that suggest that market indices can be crushed with little effort or apparent risk; stock, fund and sector performance that for some periods has appeared to defy gravity; and reports that glamorize apparent winners, denigrate so-called losers, and fuel endless speculation about the "next big thing."

Although mutual fund performance is clearly only one small part of this larger phenomenon, our commitment to the spirit of the Investment Company Act requires that we consider how our marketing efforts can contribute to the future expectations of some investors. As we have emphasized for many years in our [investor awareness materials](#), past performance is just one of several important elements of an informed investment decision. We again urge investors to keep recent market performance—including the triple-digit performance of some mutual funds in 1999—in historical perspective. We have taken the initiative of suggesting to the NASD that they consider providing additional guidance to mutual funds with respect to the use of past performance figures in advertising and sales material.

While we understandably focus much of our attention on the letter and the spirit of the Investment Company Act, the industry also recognizes that our commitment to our shareholders requires us to ensure that other systems of regulation also are working to their benefit.

This morning I will address three of these areas—market structure, privacy, and foreign regulation.

Market Structure

U.S. equity markets have a total capitalization of about \$17 trillion. Nearly \$4 trillion are attributable to mutual funds. We are the vehicle through which middle America participates in the equity markets. In the interests of our shareholders, fairness in the markets must be a top priority.

In a [speech](#) at Columbia Law School last September, SEC Chairman Arthur Levitt observed that "in the next few years, [our markets] will undergo a transformation like we have never witnessed before. ...[t]hese changes will define the marketplace for the 21st century."

Technology is allowing new entrants to compete with traditional stock exchanges. Investors are benefiting through narrower spreads, lower transaction costs, and speedier execution. The flip side of this new competition, however, is the risk of fragmentation of our national market system.

Balance is needed—between the benefits of a transparent central marketplace against the dangers of domination by a few participants, between the benefits of increased competition from new entrants against the dangers of fragmentation. As we work to achieve this balance, our investors' interests must be paramount.

Our industry must continue to take an active role in making our markets fairer and more efficient. We supported the Commission's Order Handling rules, which eliminate two-tiered pricing and ensure that all customer limit orders are made public. We supported Regulation ATS, which extends basic responsibilities such as quote display, fair access and capacity, to all market centers. These measures protect investors and encourage a level playing field.

Much more needs to be done. We strongly support decimal pricing, which will narrow spreads and achieve significant cost savings for investors, and for centralization of all Nasdaq order flow, which will improve transparency and best execution. We continue to work with the SEC and the exchanges to ensure that extended trading hours accommodate mutual fund pricing requirements.

As we work to improve our markets, we must oppose any dilution of investor protections. Competition has placed pressure on the NYSE and Nasdaq to become for-profit enterprises. One critical issue is the continued vitality of the self-regulatory role of the NYSE and the NASD. Any restructuring must preserve a strict separation of the self-regulatory function from the market that is regulated. Our industry must work with the SEC to ensure this result.

The NYSE and Nasdaq impose standards for listed companies that are designed to promote market integrity and investor protection. Increased competition and for-profit status may put pressure on the NYSE and Nasdaq to dilute these standards. We cannot allow this to happen. For that reason, we have urged the SEC to consider whether a single SRO or even the Commission itself should set listing standards.

Finally, the NYSE and Nasdaq are dominant players in the marketplace, and this dominance is likely to continue for the foreseeable future. For-profit status may provide both an incentive and an opportunity to raise their fees to unjustified levels. We must ensure that this does not happen, and that the Commission approves only justified fee increases.

In short, the integrity and vitality of our equity markets are a vital concern for our shareholders, and therefore for our industry. [Market structure issues](#) must be one of our highest priorities.

Privacy

Our commitment to our shareholders also demands that we pay close attention to legitimate concerns about privacy, the second topic that I will discuss this morning.

Confidentiality and security of customer information is nothing new for the mutual fund industry. Our success depends on the trust and confidence of our shareholders—we could not have this trust if our shareholders did not have faith that we would use their personal information solely for their benefit.

It's not surprising that privacy issues have captured Congressional and regulatory attention. The rapid evolution of e-commerce and advances in technology means that information about each of us can be stored, accessed, analyzed, and used in ways that were unimagined just a few years ago. We've all heard horror stories about the abuses that have occurred, from lack of adequate controls to outright sales of personal customer information. To some extent, these abuses are an unfortunate by-product of the Internet explosion.

Our industry has a reputation for integrity and responsibility. But technologically driven changes are occurring throughout our economy, and the mutual fund industry is no exception. As our products, services, and distribution techniques adjust to the Internet era, we must do all that we can to ensure that the good business practices that currently exist in our industry continue to protect and serve our shareholders. Similarly, we must oppose measures that would wreak havoc with the provision of traditional mutual fund services that our shareholders have every right to expect.

The [Gramm-Leach-Bliley legislation](#) enacted last year included an important breakthrough in consumer privacy. It requires all financial services firms to inform customers about their use of personal information, and to give customers an opportunity to decline to have their personal information shared with unaffiliated parties.

Just a few months after the passage of this sweeping legislation—and before rules implementing the legislation have been adopted—there are calls for additional controls. Further Congressional action is possible, even likely.

It is absolutely essential that any new privacy legislation distinguish between legitimate information sharing, which serves our shareholders' interests, and uses that are inconsistent with reasonable privacy expectations.

The unique structure of mutual funds also must be recognized. Mutual fund operations typically are conducted by a number of affiliated and unaffiliated entities. Shareholder information must flow freely between these entities in order to provide shareholders with the services they expect from those who manage and administer their fund investment. These operations do not raise privacy concerns, and it would serve no purpose for legislation to inhibit or restrict these basic fund operations.

In addition, many mutual funds communicate with their shareholders about other products and services offered by affiliates. This type of communication educates shareholders about the range of investment choices available, which leads to more informed decision-making. Legislation should not impose unnecessary hurdles to these responsible activities.

Finally, many states are considering their own unique form of privacy legislation. While well intentioned, the imposition of inconsistent state requirements would be extremely confusing and would be burdensome for companies, such as mutual funds, that do business nationwide. This is not the right result for consumers or companies. Any new federal privacy legislation must harmonize and make uniform inconsistent requirements of state law.

In short, the mutual fund industry supports a balanced approach that ensures shareholder control over personal information, without hampering efficient provision of services that shareholders have come to expect.

Foreign Regulation

The third area that I will discuss is foreign regulation. Globalization is a profoundly important phenomenon. In 1985 there were just 44 U.S. mutual funds that invested overseas, with assets of about \$8 billion. Today, there are more than 1,100 funds, with assets exceeding \$608 billion. Foreign regulation can have an important impact on the shareholders of U.S. mutual funds that invest overseas. As international investing by our industry increases, it is incumbent on us to work to ensure that foreign regulation works to the benefit of our shareholders.

Each foreign market and legal system reflects its own unique cultural, political, and economic landscape. What works well for one country may not be wise policy for another. Nevertheless, when a foreign law or policy puts our shareholders at an unfair disadvantage, it is our obligation to work for change. One example is minority shareholder rights.

A U. S. mutual fund that invests in a foreign issuer typically is a minority shareholder. Unfortunately, minority shareholders are at a disadvantage in many countries. Control shareholders may be able to sell their shares at a premium not shared by minority shareholders. In other cases, control shareholders can unilaterally disenfranchise minority shareholders or take other actions that lessen the value of their shares.

We can't address these concerns unless we understand the scope of the problem. For that reason, the Institute is surveying foreign law to detail the rights provided to minority shareholders in various key jurisdictions. We will use the survey results as a basis upon which to seek improvements in countries with corporate governance practices that harm our shareholders' interests.

The rights of minority shareholders overseas is just one issue that is capturing our attention in the global arena. New issues constantly come to light. As U.S. mutual funds increase their investments overseas, we must be attuned to foreign law and practice, and work to eliminate any unfair effects upon our shareholders.

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Our industry has had a remarkable record over the past sixty years. In an environment that encourages new entrants and vigorous competition, today nearly 7,800 funds sponsored by more than 630 mutual fund organizations are available to investors. Our shareholders have enjoyed the benefits of this free and open competition in the form of new and improved products and services and lower costs. But at the same time that we have competed in the marketplace, we have come together to work on countless policy issues, with tremendous benefits to our shareholders and our industry. We must continue this tradition.

Our shareholders have placed their confidence in us. As fiduciaries, we must work on their behalf. We must identify issues early in the process, decide what result would be in our shareholders' best interest, devise strategies to achieve that result, and work to make the result a reality.

Our shareholders' interests will take us in many different directions in years to come. It's impossible to predict which policy debates, whether at home or abroad, may require our attention. This morning, I have discussed just three—the fairness and efficiency of our securities markets, use of our shareholders' personal information, and issues that we encounter under foreign law. These are just examples. There are many, many others, from retirement plan regulation to tax matters to electronic commerce.

Though the issues and challenges that we face may vary tremendously, our credibility and effectiveness in each one will depend on how well we honor the spirit as well as the letter of our core statute, the Investment Company Act. This will always be our touchstone.

We must ensure that the Investment Company Act keeps pace with the changing needs of investors. We must vigorously oppose efforts to dilute the core principles of the Act. We must be the fiercest critics of our own practices and never hesitate to adopt voluntary best practices that exceed legal requirements whenever needed. And we must put aside individual differences to work for the common good, as we have just done in the area of mutual fund performance advertising.

In sum, our future as an industry will depend on whether we continue to heed Vince Lombardi's advice—whether each individual mutual fund organization continues its commitment to a group effort on behalf of all mutual fund shareholders. By doing so, we will be true to the tradition of integrity that each of us is heir to, and we will remain deserving of the confidence and faith that has been placed in us.

Thank you.

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