Independent Directors Council

Promoting Excellence in Fund Governance

2005 Operations and Technology Conference: Keynote Remarks

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Keynote Remarks by

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Good morning. My name is Dan Crowley. It's my pleasure to be with you today. Our President, Paul Stevens, asked me to convey his regret that he could not be here. I know Paul was looking forward to being with you and was very disappointed that he was called away on other urgent business.

As Chief Government Affairs Officer, I head a team of professionals dedicated to representing the interests of mutual funds, their advisors and investors before Congress and the Executive Branch of the federal government. I want to emphasize at the outset that these remarks represent my personal views and are not intended as an expression of official Institute policy. My purpose today is to explore with you the current environment in Washington, D.C., to give you a sense of what we hope to be able to achieve for the benefit of mutual fund investors, and to offer a couple of suggestions on how you can help.

The Policy Environment in Washington

Following the 2004 election, in which Republicans maintained the Presidency and the Majority in both houses of Congress, there was extensive discussion about the need to incentivize long-term savings and to enhance the retirement security of millions of Americans. President Bush exercised considerable leadership in calling for reform of the social security system, previously deemed to be the “third rail” of American politics – touch it and you die. The President recognized that the current economics of the social security system are such that its long-term solvency is unsustainable – and he expended a significant amount of political capital at some risk in calling for reform. He also emphasized that private sector solutions are needed to address the long-term solvency of social security. In that context, the Institute recognized that mutual funds are a critical part – indeed the foundation - of retirement security. Not because they might be suitable vehicles for social security assets, but rather because of their supporting role with respect to the other two legs of the retirement security stool – employer provided retirement accounts, such as 401(k)s, 403(b)s, etc., and individual retirement accounts, particularly the IRA.

In my view, mutual funds are simply the most effective way for most Americans to receive low cost portfolio diversification as well as professional portfolio management. In fact, mutual funds have democratized investing in the United States and have helped create a culture of investing here that is unparalleled in the rest of the world. We as an industry therefore have a responsibility to ensure the safety and integrity of our products, and to be ever mindful of our fiduciary role as the custodians of these assets. Frankly, that role was questioned in the wake of the trading scandals. However, by consistently demonstrating that our immediate, instinctive reaction in the face of such challenges is to always ask “what is the right thing for investors?” we have managed to retain their confidence. Some may question, for example, whether the Institute’s position on such issues as the hard 4:00 pm close or mandatory redemption fees were optimal from the standpoint of mutual fund advisors, brokers or other intermediaries – but no one can credibly question whether those positions were consistent with investor interests.

At the beginning of each session of Congress, the Institute’s government affairs team asks a very simple question – “What public policy changes would be consistent with the interests of mutual fund investors, as well as fund managers, and what can we do to achieve them?”

The Institute’s Current Policy Agenda

This year, given the national focus on retirement security issues, we decided to advance the following policies:

- Defer taxation of automatically reinvested capital gains: In short, we want to strengthen the ability of mutual fund investors to save for retirement by deferring taxation of automatically reinvested capital gains. I will elaborate about the GROWTH Act in a moment.
- Modernize the rules regarding who may offer investment advice to workers in a 401(k) plan: Make it easier for 401(k) investors to turn to the professionals most familiar with their 401(k) plan investment options for advice.
- Make permanent the retirement, education and other savings incentives enacted in the 2001 tax package: These provisions increased IRA and 401(k) savings limits, created 529 plan options, authorized “catch up contributions” from older savers, and more. They are now scheduled to expire in 2010.

- Make permanent the reduced tax rates on capital gains and dividends enacted in the 2003 tax package: These provisions are now scheduled to expire in 2008.
- Encourage greater participation in employer retirement plans by encouraging that workers be automatically enrolled unless they opt out: Currently, 20 percent of those eligible to participate in 401(k) plans fail to do so. Making participation automatic unless workers opt out will likely improve participation greatly.
- Permit greater retention of retirement savings by delaying the date at which IRA savers must begin taking withdrawals: Currently, distributions must begin at age 70 and a half, yet people now expect to live longer in retirement and must be careful about how quickly they deplete their precious retirement assets so that they do not experience their fear – outliving their money.
- Encourage the creation of new and more universal tax-advantaged savings opportunities.

The GROWTH Act

The bipartisan "Generating Retirement Ownership Through Long-Term Holding" (GROWTH) Act, (H.R. 2121 and S. 1740), introduced in the House in May by Rep. Paul Ryan (R-WI) and Rep. William Jefferson (D-LA) and in the Senate in September by Sen. Mike Crapo (R-ID) and Sen. Tim Johnson (D-SD) would be a valuable contributor to retirement savings efforts.

The GROWTH Act, which currently has 40 bipartisan cosponsors in the House, and 5 bipartisan sponsors in the Senate, would keep more retirement savings invested and growing longer by deferring taxation of automatically reinvested capital gains until fund shares are sold, rather than allowing those long-term gains – which generate no current income or cash in hand – to be taxed every year.

Many of today's workers do not yet have in place the retirement savings supplement to Social Security that is needed for a secure retirement. In fact, almost half of American workers – nearly 71 million of 151 million workers – are not offered any form of pension or retirement savings plan at work.

Meanwhile, the number of years spent in retirement is growing. So too are the costs individuals can expect to bear in retirement. For example, the Employee Benefit Research Institute estimates that an individual retiring at age 65 in 2014 will need $285,000 just to cover health coverage premiums and expenses.

Mutual funds are a hugely important part of American workers' preparation for retirement, both through their employers' retirement plans and on their own. Mutual funds now make up half of the $3.2 trillion held by American workers through 401(k) plans and other similar job-based savings programs. More than 30 million American households are saving through taxable mutual fund accounts, either as supplements to their employers' plans or because they do not have such plans.

Mutual fund investors who automatically reinvest are doing the right thing. They are saving for the long term, contributing to our national economy, and building up their own retirement nest egg. These Americans should be encouraged to save – not punished for doing so through a tax on automatic reinvestments.

Millions of Americans would benefit from the GROWTH Act – those mutual fund investors now saving on their own for retirement without access to an employer-sponsored plan, those now supplementing their employer's plan because they know that plan won't provide enough savings, and the millions of working Americans who have no access to an employer-sponsored plan and haven't yet begun to save on their own.

In summary, Americans need to do more to prepare for their retirement and the GROWTH Act provides middle income Americans a better tool to grow their long-term retirement savings.

Lifetime Payment Accounts

Congress is also exploring the use of tax incentives to encourage baby-boomers on the verge of retirement to annuitize their retirement income. In pursuing the laudable policy goal of making retirement savings last a lifetime, Congress should recognize and include the varied alternatives of financial services and products that fulfill this purpose, including "Lifetime Payment Accounts." In short, given the grave challenges in meeting retirees' lifetime income needs, no one solution can be expected to be a panacea, and therefore Congress should encourage the use of all products that can perform a useful role.

Policymakers are concerned both with helping individuals build up retirement savings and encouraging the careful spending of those savings to last throughout the retirement years. For some people entering retirement, insurance products may offer all or part of that distribution help. However, no one financial product is best suited to address all of the risks that individuals can potentially face in retirement and more than one financial product enables individuals to secure a lifetime stream of payments.

Lifetime Payment Accounts (LPAs), for example, are systematic withdrawal programs that provide periodic distributions from mutual fund accounts over the investor's life. For many people entering retirement, this will be the simple, flexible and affordable path that is best suited to their needs and those of their families. Any new distribution assistance incentives should recognize and encourage this option, too – otherwise, many of the retirement savers in need of this help may find themselves left out.

Again, tax incentives for promoting lifetime distributions should be afforded to the range of financial services and products that meet the policy goals of lifetime security and the broad range of retirement savers who need and value those varied options. LPA savers in mutual funds are generally protected against inflation risk because market returns will typically adjust when expectations of inflation increase. With the average life expectancy of 65-year-old individuals extending into their 80s, a reasonable amount of market risk – as part of a diversified investment portfolio with the potential for greater returns – is appropriate for most individuals to address inflation risk and the resulting decline in purchasing power.

How Can You Help?

Whether we will be successful in Washington depends on several factors, some of which are simply beyond our control. Pressures on the federal budget caused by the deficit, the continuing war in Iraq, and most recently the colossal damage caused by hurricanes Katrina and Rita, mean that it will be quite difficult politically to enact new tax incentives. However, members of the Republican leadership in Congress, particularly House Ways & Means Committee Chairman Bill Thomas, remain committed to broad retirement security legislation. In the short term, you are likely to see a continuation of the efforts to reform the pension or "defined benefit" system, in part due to the recent bankruptcy filings of a couple of major airlines and the looming insolvency of the Pension Benefit Guarantee Corporation. We hope that the broader question of retirement security, particularly improvements on the "defined contribution" side such as those I have described will be included.

In conclusion, which reforms prevail will depend on how broad the support for each proposal. Politics is about who gets what, when and how. Our goal therefore is to develop support for our proposals at the grassroots level – that is to say, among investors. If enough elected officials hear from enough investors, we will be successful. The tremendous support we have received for the GROWTH Act in a relatively short time tells me that we are on to something significant that will benefit millions of mutual fund investors. Since many of you are involved in mutual fund operations, I would be remiss if I did not at least suggest that you are perhaps in the best position to help us pursue some of these policies. With respect to our objective of creating tax incentives for Lifetime Payment Accounts, for example, many of you already provide retirement planning tools via your company web sites. I suggest to you that simply adding this one additional feature – allowing your investors to elect withdrawals over their remaining life expectancy – would make our job in Washington significantly easier. Similarly, creating web links to www.fundingyourfuture.org would help us give your investors a way to express their support for the GROWTH Act directly to their representatives in Congress.

Thank you for having me, and for your help. I offer my best wishes for a successful conference.
