

a Tradition
of Integrity

60 Years *of*
Shareholder
Protection

“The foundation for the continuing success of the mutual fund industry is based on the comprehensive program of federal regulation under the Investment Company Act, which has earned the trust and confidence of our shareholders.”

INSTITUTE PRESIDENT MATTHEW P. FINK

INVESTMENT COMPANY INSTITUTE

Annual Report 1999

About the Investment Company Institute

The Investment Company Institute (ICI) is the national association of the investment company industry. Its mission is to advance the interests of investment companies (mutual funds, closed-end funds, and unit investment trusts) and their shareholders, to promote public understanding of the investment company business, and to serve the public interest by encouraging adherence to high ethical standards by all elements of the business. As the only association of U.S. investment companies without regard to distribution method or affiliation, the Institute is dedicated to the interests of the entire investment company industry and all of its shareholders. The Institute represents members and their shareholders before legislative and regulatory bodies at both the federal and state levels, spearheads investor awareness initiatives, disseminates industry information to the public and the media, provides economic policy and other policy research, and seeks to maintain high industry standards.

Established in New York in 1940 as the National Committee of Investment Companies, the organization was renamed the National Association of Investment Companies in 1941 and the Investment Company Institute in 1961. The Institute relocated to Washington, DC in 1970. The association was originally formed by industry leaders who supported the enactment of the Investment Company Act of 1940, legislation that provided the strong regulatory structure that has been responsible for much of the industry's success.

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Special Section

60 Years of Shareholder Protection 1940 – 2000

“I have great hopes that the Act which I have signed today will enable the investment trust industry to fulfill its basic purpose as a vehicle to diversify the small investors' risk...”

President Franklin D. Roosevelt
Investment Company Act Signing Ceremony
August 23, 1940



a Tradition *of* Integrity

By John J. Brennan
Chairman, Investment Company Institute
and
Matthew P. Fink
President, Investment Company Institute

*N*ineteen ninety-nine marked the beginning of the 60th year of shareholder protection under the Investment Company Act of 1940, which laid the foundation for the modern mutual fund industry.

the Forties



Since 1940, mutual funds have enjoyed steady growth, with assets increasing from less than \$450 million to more than \$6 trillion in 1999. Today, nearly half of all U.S. households own mutual funds.

Many factors have contributed to the industry's success – a growing economy, strong securities markets, an expanding middle class, and government policies that promote retirement savings. But these factors affected all financial products, not just mutual funds. Something else accounts for the extraordinary public acceptance of mutual funds.

What sets us apart? In our view, the key to our success lies in our industry's 60-year commitment to integrity, our shareholders' interests, and strong regulation.

To put things in proper perspective, we need to look back to this industry's earliest days. Investment companies – companies that sell shares to the public and invest the proceeds in diversified pools of securities – first became popular in the 1920s. Most were closed-end funds, companies that issue a fixed number of shares that trade in the secondary market. Mutual funds, investment companies that issue redeemable securities, were less common.

1940 Investment Company Act is signed into law, setting the structure and regulatory framework for the modern mutual fund industry.

1944 The NAIC begins collecting industry statistics.

1940 1941 1942 1943 1944 1945 1946 1947 1948 1949

1940 National Committee of Investment Companies formed. [In 1941, the name is changed to the National Association of Investment Companies (NAIC), renamed the Investment Company Institute (ICI) in 1961.]

1945 Mutual fund assets top \$1 billion.

1949 Mutual fund shareholder accounts total 842,000 in 91 funds.

While most investment companies were operated prudently, some engaged in questionable activities. In 1935, Congress directed the Securities and Exchange Commission to undertake a major study of fund industry. The SEC undertook a six-year study, culminating in a 5,100-page report and recommendations for stringent federal legislation.

Many observers predicted that the industry would oppose legislation and that this opposition would prevent enactment. Instead, industry leaders concluded that strict legislation would prevent the recurrence of abuses and restore public

confidence in the industry. The need to reinforce a culture of integrity is captured in the words of an industry leader in the 1930s, Arthur Bunker, who testified before Congress: "We recognize that abuses have existed and we believe that legislation is necessary to prevent their continuance and to help the better elements of the industry to raise the standards of the industry to increasingly higher levels."

A critical step was taken when representatives of mutual funds and closed-end funds agreed to put aside their traditional rivalry and work together for the benefit of all shareholders. Industry leaders then

the Fifties



supported the bill that the Congress passed unanimously and was signed into law on August 23, 1940. President Roosevelt, congressional leaders, and SEC officials noted the remarkable spirit of cooperation between government and industry that resulted in the Investment Company Act. "This attitude on the part of the investment trust industry and investment advisers is most commendable," President Roosevelt said during the signing ceremony.

Both the cooperative spirit evident in 1940 and the key shareholder protections that spirit produced have

"Many predicted the industry would oppose legislation ... Instead, industry leaders concluded that strict legislation would prevent the recurrence of abuses and restore public confidence."

1951 The total number of mutual funds surpasses 100, and shareholders exceed 1 million for the first time.

1954 For the first time, households net purchases of fund shares exceed those of corporate stock.

1950 1951 1952 1953 1954 1955 1956 1957 1958 1959

1953 The first U.S.-based international mutual fund is introduced.

1959 Mutual fund shareholder accounts total 4.3 million in 155 funds.



“Despite the vast changes that have taken place over the last six decades, the Institute continues to follow the basic precepts adopted by industry leaders in 1940.”

endured and succeeded to this day. Mutual fund shareholders benefit from a regulatory system whose core protections — oversight by independent directors, bans on affiliated transactions, daily marking to market of assets, limits on leveraging, and full disclosure — are unparalleled in the financial services world.

The National Committee of Investment Companies, the predecessor of the Investment Company Institute, was formed to serve as a continuous liaison between the SEC and the fund industry. Its first meeting was held on October 1, 1940.

the Sixties



Originally, the Institute's work was devoted to SEC regulation of investment companies. Over the years, as the industry grew and evolved, the Institute's work expanded to cover an active legislative agenda and other areas, including taxation of investment companies and their shareholders, industry statistics, public information, economic research, retirement plans, operational issues, market structure, and international matters.

Despite the vast changes that have taken place over the last six decades, the Institute continues to follow the basic precepts adopted by industry leaders in

1940 — collaboration by all segments of the industry, cooperation with government, and, above all, a commitment to serving the best interests of investment company shareholders.

In the years to come, we will face many new challenges. Globalization, financial restructuring, electronic commerce, privacy concerns, and countless new developments in products, services, and markets. But, as important as these issues are, our future will largely depend on preserving the industry's culture of integrity.

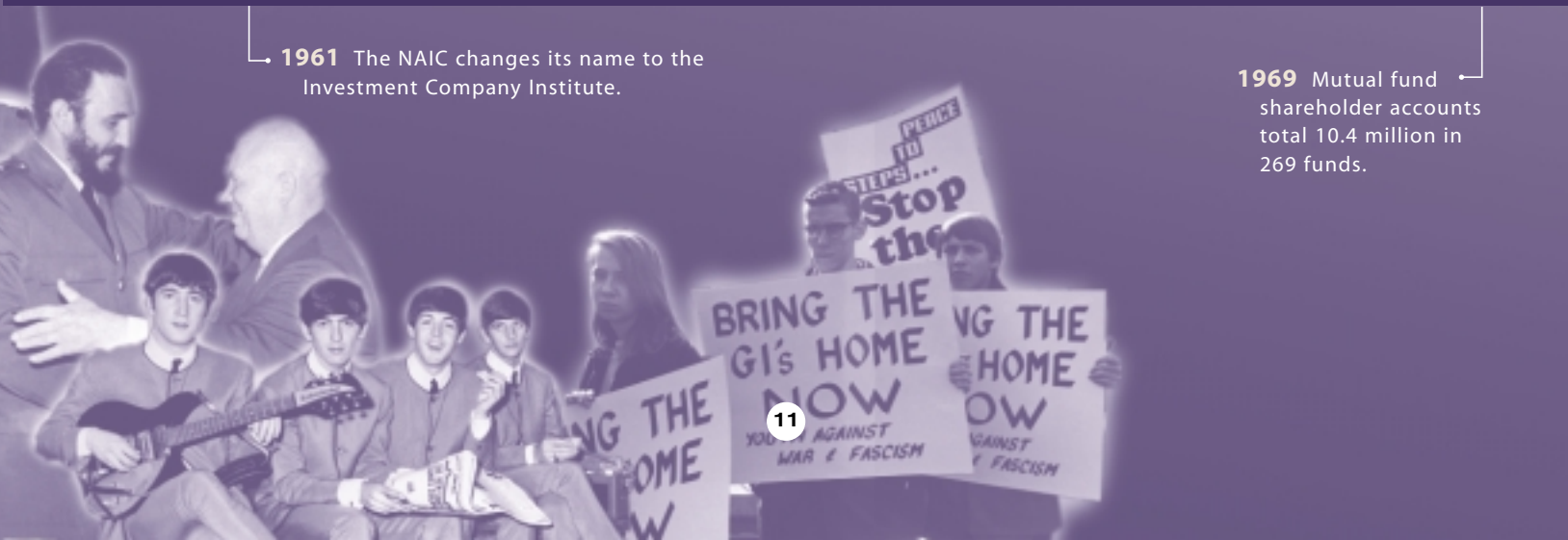
→ **1961** First tax-free unit investment trust offered.

→ **1962** Self-employed Individual Retirement Act of 1962 (Keough) creates savings opportunities for self-employed individuals.

1960 1961 1962 1963 1964 1965 1966 1967 1968 1969

← **1961** The NAIC changes its name to the Investment Company Institute.

← **1969** Mutual fund shareholder accounts total 10.4 million in 269 funds.



the Pillars *of* Protection

By Paul Roye

Director, Division of Investment Management
U.S. Securities and Exchange Commission

(The following is adapted from Paul Roye's keynote address at the 1999 General Membership Meeting of the Investment Company Institute.)

At the dawn of a new century comes the 60th anniversary of the enactment of the Investment Company Act of 1940, one of the most successful statutes regulating financial institutions.

the Seventies



Trillions of dollars have been invested in U.S. mutual funds, without the benefit of a single dollar of government guarantee, subsidization, or bailout. Over the years, mutual funds have contributed untold amounts to capital formation in the United States, as well as in many foreign markets, including developing markets.

I believe that the success of this industry was, and will remain, dependent on its ability to command the confidence of investors. That confidence is based

in no small measure on the effectiveness of the 1940 Act in preventing many of the abusive practices that prompted its adoption. The 1940 Act created what I would call the “four pillars of protection” for mutual fund investors. These protections give investors confidence that:

- ▶ Their investments will be managed in accordance with the fund’s investment objectives;



- ▶ The assets of the fund will be kept safe;
- ▶ When they redeem, they will get their pro rata share of the fund's assets; and
- ▶ The fund will be managed for the benefit of the fund's shareholders and not the fund's adviser or its affiliates.

We would all agree that the 1940 Act successfully addressed the abuses that

occurred before its enactment. But the true genius of the Act was its drafters' understanding that markets and circumstances change, and that industries evolve. The exemptive authority given to the Commission in the 1940 Act makes the Act flexible and allows it to accommodate change and innovation in ways that preserve the Act's underlying principles. This flexibility permitted the development of money market funds, variable insurance products, expanded international investing,

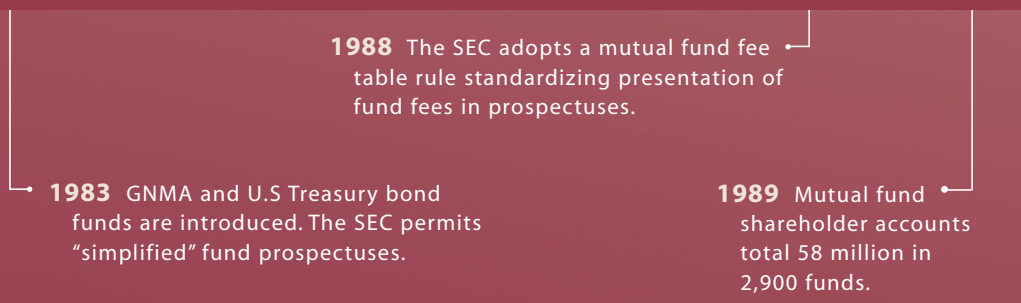
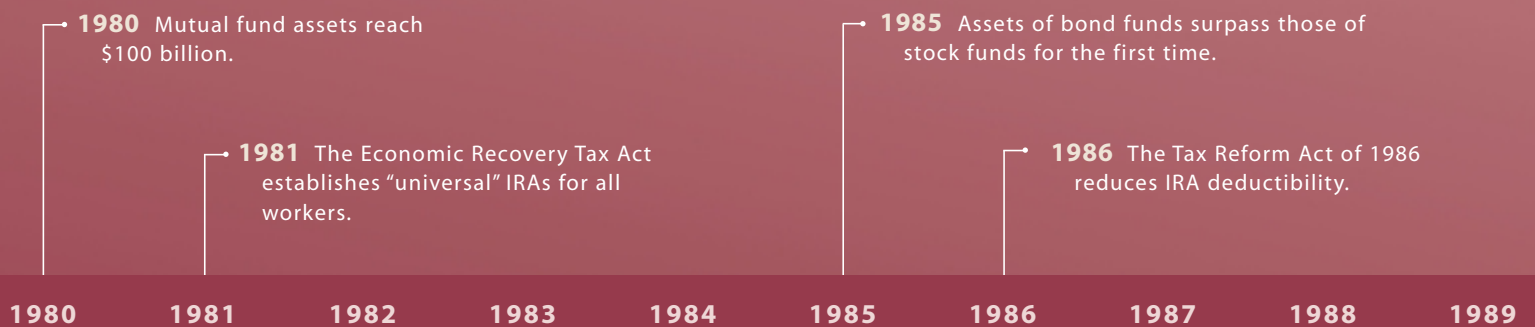
the Eighties



alternative distribution arrangements, securities lending programs, and unique exchange-traded products that serve particular investor needs.

Another unique aspect of the 1940 Act is the requirement that investment companies have independent directors. As far as I know, investment companies are the only U.S. companies that are required by law to have independent directors. Investment company directors are called upon to safeguard the interests of fund shareholders and

“Over the years, mutual funds have contributed untold amounts to capital formation in the United States, as well as in many foreign markets, including developing markets.”



“From an investor protection standpoint, the 1940 Act’s provisions concerning affiliated transactions are at its heart and serve as a fundamental protection.”

ensure that the “pillars of protection” are not breached.

From an investor protection standpoint, the 1940 Act’s provisions concerning affiliated transactions are at its heart and serve as a fundamental protection. The provisions of Section 17(a) have not prevented the growth of mutual funds nor their attractiveness as the investment option of choice for millions of small investors. The importance of the prohibitions against affiliated transactions to mutual fund investors

the **Nineties**



and to the mutual fund industry cannot be underestimated and the consequence of their demise cannot be overestimated.

themselves actively urged that an agency of the federal government assume immediate supervision of their activities.”

I believe the fund industry recognizes the importance of strong rules to prevent abusive practices. And from the start, I believe that the fund industry has recognized this. In fact, President Roosevelt noted at the signing ceremony for the Investment Company Act in 1940 that “the investment trusts have

As we consider the emerging issues for the mutual fund industry beyond the Year 2000, I think it is important to consider the factors that have contributed to the success of the industry today. The one factor that has been at the very heart of the industry’s success is the fundamental integrity and credibility of the mutual fund industry.

1990 Mutual fund assets top \$1 trillion.

1992 SEC publishes *Protecting Investors: A Half Century of Investment Company Regulation*, which concludes that the 1940 Act provided “the framework for the development of a dynamic industry.”

1998 The SEC approves the most significant disclosure reforms in the history of U.S. mutual funds.

1997 The Taxpayer Relief Act of 1997 creates the Roth IRA and eliminates restrictions on portfolio management that disadvantage fund shareholders.

1990 1991 1992 1993 1994 1995 1996 1997 1998 1999

1996 The National Securities Markets Improvement Act reallocates federal and state regulation of mutual funds; the Small Business Job Protection Act creates SIMPLE plans and other retirement savings incentives for employees of small businesses.

1999 Mutual fund shareholder accounts total 228 million in 7,791 funds.

Endorsing Effective Legislation and Regulation

*A*dvancing the interests of investment companies and their shareholders through effective legislation and regulation is a hallmark of our industry. Thus, a considerable portion of the Institute's work concerns representation of the mutual fund industry and its shareholders before Congress, the Securities and Exchange Commission, other federal regulatory agencies, and state and foreign regulators. No matter the issue or venue, our underlying principle remains the same – to ensure that mutual fund regulation and legislation continues to provide effective investor protection and responds to evolving investor needs and developments in financial markets.

“The most enduring factor of our industry’s success has been our willingness to work together to ensure that laws, regulations, and voluntary business practices protect and serve our shareholders.”

Institute President Matthew P. Fink

FINANCIAL SERVICES MODERNIZATION

The Institute has long supported financial services reform that protects investors through functional regulation while ensuring competitive fairness. In November, President Clinton signed into law historic financial services reform legislation that will allow affiliations among registered investment companies, banks, securities firms and insurance companies, and other financial services firms.

The Gramm-Leach-Bliley Act repealed the Glass-Steagall Act and amended the Bank Holding Company Act to permit these affiliations. In Congressional testimony supporting financial services reform legislation, Institute President Matthew P. Fink asserted that allowing affiliations among all types of

financial companies “represents a major step forward in the effort to modernize the nation’s financial laws and to realign the financial services industry in a manner that should benefit the economy and the public.” The legislation recognizes the SEC’s primary examination authority over investment companies. The Institute supports the concept of functional regulation that respects, and is carefully tailored to, the divergent requirements of each of the business sectors that comprise the financial services marketplace.

“We will continue to push our program for the protection of the investor on all fronts because we are convinced of its essential soundness,” President Roosevelt said in the text of his statement on signing the Investment Company Act of 1940 into law.



BEST PRACTICES FOR FUND DIRECTORS

The Investment Company Act of 1940 and SEC regulations set out specific requirements for investment company directors that are unique in the world of American business. The broad consensus is that this governance system has worked well for investment company shareholders. Nevertheless, this system of director oversight, like any other, must periodically be reexamined to ensure its continuing effectiveness.

This year, SEC Chairman Arthur Levitt's invited the fund industry to work with the Commission to further enhance the effectiveness of fund directors. In response, the Institute announced the formation of an Advisory Group on Best Practices for Fund Directors. The six-member Advisory Group consisted of three experienced independent fund directors and three senior executives of major fund management organizations who serve as affiliated directors of the funds managed by their organizations. The Group recommended 15 best practices to strengthen the independence of outside directors and enhance the effectiveness of mutual fund boards in general. The Group consulted with a wide range of experts, as well as with members of the Institute's Director Services

Committee, the Institute's Small Funds Committee, and other groups of members in developing the recommendations. Shortly after the group released its report, the Institute's Board of Governors unanimously approved its recommendations, urging members to take action appropriate to their respective circumstances as soon as reasonably practicable to implement the recommendations.

Among the Advisory Group's 15 recommendations:

- ▶ Independent directors should represent a "super-majority" of at least two-thirds on fund boards.
- ▶ Former officers or directors of a fund's investment adviser, principal underwriter, or certain of their affiliates should not serve as independent directors.
- ▶ Independent directors should have qualified, independent legal counsel.
- ▶ Independent directors should meet separately from management when they are considering the fund's advisory and underwriting contracts and otherwise as they deem appropriate.

John J. Brennan (left), Chairman, Investment Company Institute and Chairman and CEO, The Vanguard Group Inc.; Dawn-Marie Driscoll, independent director, Scudder Funds; and Paul Haaga, Executive Vice President, Capital Research and Management Company were among the members of the Advisory Group on Best Practices for Fund Directors who outlined the group's recommendations to enhance mutual fund governance during a news conference at the National Press Club in Washington, DC.



SEC Chairman Levitt commended the Institute for responding quickly to his challenge, calling the report “an important step forward” in enhancing the effectiveness of fund directors.

DATA PRIVACY

The fund industry takes very seriously all issues concerning the use and protection of shareholders’ personal information. The industry strongly supports the disclosure requirements included in the Gramm-Leach-Bliley Act. The approach taken by the Act strikes an appropriate balance between the protection of consumer privacy and the legitimate business needs of the mutual funds in which 83 million Americans invest.

The Gramm-Leach-Bliley legislation 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 third parties. Shortly after passage of this sweeping legislation – and before rules implementing the legislation had been adopted – there were calls for additional controls. 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. Many states also are considering their own unique forms of privacy legislation. The Institute is actively seeking consistency in national privacy standards. Any new federal privacy legislation must harmonize and make uniform inconsistent requirements of state law to maximize shareholder protection.

ELECTRONIC COMMERCE

The rapid growth of financial transactions conducted electronically is receiving serious attention in Congress. Legislation that provides for the acceptance of electronic signatures and records in interstate commerce, including securities transactions, by according electronic signatures and records the same legal effect and validity as written ones, is under consideration by Congress.

Paul Roye (left), Director, SEC Division of Investment Management, and Institute General Counsel Craig Tyle talk during an Institute conference at which Roye said the oversight provided by fund boards will become increasingly important in the new millennium.



This legislation is designed to serve as a stop-gap measure until states adopt the standards in the Uniform Electronic Transactions Act (UETA), which will establish uniformity for the interstate use of electronic signatures.

Because easy access to Internet information and commerce is important to mutual fund shareholders, the Institute supports the three-year moratorium on state and local Internet access taxes. The moratorium provides time to assess whether taxes imposed by state and local governments threaten the continued growth of the Internet and electronic commerce.

PERSONAL INVESTING

The personal investing activities of portfolio managers and others in the investment company industry are governed by the unique system of safeguards that protect mutual fund shareholders. Despite regulatory scrutiny, personal investing by investment company

personnel has been the source of relatively few enforcement actions. One reason why relatively few enforcement actions have been necessary is that the investment company industry has placed a high priority on developing effective codes of ethics, unparalleled elsewhere in the financial services industry.

Congress and the SEC have long recognized that conflicts of interest may arise when investment company personnel trade for their own accounts. In 1970, Congress authorized the SEC to adopt rules requiring all mutual funds and their investment advisers and principal underwriters to adopt codes of ethics to address these potential conflicts. In 1994, an Institute Advisory Group on Personal Investing developed recommendations concerning standards governing personal trading activities of mutual fund personnel. An overwhelming majority of fund groups have voluntarily adopted these measures. In 1999, the SEC tightened rules governing personal investing by investment company personnel.

In October, 1941, the National Association of Investment Companies (NAIC) was formed by members of the National Committee of Investment Companies, who decided the industry needed a more permanent organization. The NAIC, based in New York, was formed with 68 mutual fund and 43 closed-end fund members.



Amendments to Rule 17j-1 require greater board oversight of personal investing by portfolio managers and other personnel, additional reporting of securities holdings, and pre-clearance of investments in initial public offerings and private placement transactions.

SECTION 17(A)

One of the core protections of the Investment Company Act of 1940 is the ban on affiliated transactions. For 60 years, this fundamental protection has served to prevent the reemergence of a wide array of abuses that occurred in the 1920s and 1930s. Section 17 of the Investment Company Act accomplishes this by preventing those with the potential power to influence or control an investment company from using that power for their own financial advantage. Section 17(a) is perhaps the most important of these protections because it prohibits people who are directly or indirectly affiliated with a mutual fund from engaging in transactions with that fund as principal.

In 1999, this vital shareholder protection was challenged. As part of the suggestions proposed to Congress was a proposal to substantially repeal Section 17(a) to allow a securities dealer to sell from its own inventory a broad range of stocks, bonds, and other securities to mutual funds managed by the dealer's firm.

The Institute, the SEC, and others vigorously opposed the proposal. At the Institute's General Membership Meeting in May, SEC Division of Investment Management Director Paul Royce expressed the Commission's strong opposition to weakening this core protection of shareholders. The Institute will continue to oppose efforts to repeal this important shareholder protection.

Institute President Matthew P. Fink greets House Banking and Financial Services Chair Marge Roukema (R-NJ) before testifying on the vital importance of understanding the structure of mutual funds when considering information-sharing issues at the heart of the national debate on privacy.



U.S. TRADE AND MARKET ACCESS

As investors seek opportunities in the global marketplace, the Institute works with representatives of foreign nations and U.S. government officials to seek regulatory improvements that enhance the competitiveness of U.S. money management firms abroad. The Institute advocates lowering the barriers that prevent U.S. asset management firms from marketing their services and products around the world.

The Institute's international agenda is focused on achieving a true cross-border market for mutual funds in Europe; assuring that publicly offered mutual funds can be used as funding vehicles in the defined-contribution market in Europe and Japan; and reducing barriers to U.S. advisers seeking to offer mutual funds in certain Asian countries.

The Institute advocates the removal of barriers to foreign investors in U.S. funds as individuals around the world increasingly are turning to mutual funds to meet their diverse investment needs. While the U.S. fund industry is the global leader, foreign investment in U.S. funds is low. Today, less than one percent of all U.S. fund assets are held by non-U.S. investors. In an effort to increase the competitiveness of U.S. funds among foreign investors, the Institute supported legislation in 1999 to eliminate a barrier discouraging foreign investment in U.S. securities through U.S. mutual funds. Foreign investors would receive the same withholding tax treatment for interest and short-term capital gains received from U.S. mutual funds as they would receive if they invested either directly or through a foreign mutual fund. The provision was included in the tax relief bill passed by Congress in 1999.



Two years after the Investment Company Act was signed into law, an editorial in Barron's concluded: "There is every reason to believe that eventually the Investment Company Act of 1940 will have proved itself the most important factor contributing to the establishment of investment trusts in their rightful place among this country's financial institutions."

STATE LEGISLATIVE ISSUES

The Institute continues to work actively with the states to amend their securities acts and related rules to ensure that the provisions of the National Securities Markets Improvement Act of 1996 (NSMIA) are implemented uniformly. All states that impose notice filing requirements on investment companies have adopted as their filing forms the uniform notice form developed by the North American Securities Administrators Association (NASAA) and the Institute. Thus far, all but a dozen states have simplified the filing requirements imposed on investment companies by eliminating the need to routinely file prospectuses. In addition, the Institute has worked with Colorado, Iowa, and Ohio as they have amended their securities acts to add provisions regulating investment advisers. As a result, these provisions have been implemented uniformly across these states.

SEC FUNDING

The Institute consistently supports increasing the appropriation to the SEC because adequate financial resources for the SEC are essential to continue effective regulatory oversight and important investor protection and awareness initiatives. At the same time, the Institute believes that fees paid to the SEC should be directly related to a level commensurate with the agency's budget. However, since 1983, the securities industry has paid as much as four times more in fees each year than is allocated to the SEC for regulatory oversight. The Institute believes fee levels should be lowered to a level commensurate with the SEC's appropriation and should not be considered general revenue to be spent on items not related to securities regulation. The Institute also supports SEC efforts to raise staff compensation to levels comparable with those of the banking regulatory agencies as a way to enhance the SEC's recruitment and retention efforts. Adequate staffing resources are essential for the SEC to fulfill its mandate.

Securities and Exchange Commission Chairman Arthur Levitt (right), John A. Koskinen, chair of the President's Council on Year 2000 Conversion, and Institute President Matthew P. Fink brief reporters on the preparations the industry has taken to prepare for the century date change. The Institute and its members devoted significant time and resources to preparing for the technological, coordination, and communication challenges posed by the crossover to the new millennium. The goal for all segments of the securities industry was to do everything possible to keep the financial markets functioning "business as usual" during the Year 2000 (Y2K) crossover. These efforts succeeded as the Y2K crossover occurred without significant incident.



Enhancing Retirement Security Opportunities

The challenge facing Americans today is to ensure that they prepare for their financial needs in retirement. This challenge is particularly pressing in light of two demographic events. First, members of the “Baby Boom” generation are rapidly approaching their retirement years. Evidence from recent studies strongly suggests that, as a generation, they have not adequately saved for their retirement. Second, Americans today are living longer.

“Providing additional opportunities for Americans to save for retirement is an extremely important national policy objective.”

Institute Chairman John J. Brennan

In order to ensure that individuals have the financial resources to support themselves in their retirement years, they will need to save aggressively for these years. Providing additional opportunities for Americans to save for retirement and removing barriers that limit the ability of many individuals to save are key policy goals.

Employer-sponsored plans, such as 401(k) plans, and individual savings programs, such as the Individual Retirement Account, or IRA, have enabled millions of individuals to prepare for their retirement. Given the success of the current programs for so many

individuals, the Institute believes that all Americans should be encouraged to participate in them. Increased incentives for long-term savings, such as those in the President's retirement savings account proposal, would encourage even broader participation in the private pension and savings system. If Congress chooses to proceed with the retirement savings account proposal, the Institute advocates that the program should include a significant public

In 1957, the National Association of Investment Companies (later renamed the Investment Company Institute) produced its first investor education film on saving for retirement, “The Hope that Jack Built.”



education campaign on investing. We believe the President and Congress should work together to assure individuals of all income levels and in all workplaces adequate opportunity and incentives to achieve retirement income security.

In testimony before Congress, the Institute stressed that positive changes to the present system will increase long-term savings. In particular, the Institute is a strong proponent of policy measures that would establish simpler and more accessible retirement plans, including support for measures that would encourage small employers to establish retirement plans and would make plan balances more portable. The Institute also strongly supports measures that would expand IRA eligibility and would establish “catch-up rules” to allow additional IRA and 401(k)

contributions by individuals 50 years and older who may have been unable to save during their early working years.

EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA)

The passage of the Employee Retirement Income Security Act (ERISA) over 25 years ago was a landmark event. Its goal was – and remains – to protect Americans’ pensions. To accomplish its goal, ERISA established new legal standards for retirement plan trustees and other plan fiduciaries. The core fiduciary and trust requirements of ERISA hold plan fiduciaries to the highest standards of loyalty and prudence and assure that plan assets remain segregated from corporate assets and



The NAIC's first General Membership Meeting was held October 22-23, 1959, at the Hotel Savoy-Hilton in New York.



protected against the claims of company creditors. These broad standards have fostered a safe, secure pension plan environment.

Although ERISA was enacted when pension plans were primarily of the defined-benefit type, it continues to be a success story. It protects the rights of participants and beneficiaries and plan assets effectively in the current pension environment where defined contribution plans play a significant role. Nonetheless, in some respects, ERISA has not kept pace with changes in our retirement system or the financial markets. For this reason, we encourage Congress to modernize ERISA to assure that retirement plan participants are able to obtain the services they need, while continuing to assure that they and their retirement savings are fully protected from abuses. Plan participants should be able

to readily obtain the investment assistance they need in managing their growing 401(k) plan investments; and various regulatory processes can be streamlined to the benefit of plans and their participants.

EMPLOYER-SPONSORED RETIREMENT PLANS

Improving incentives to save by increasing contribution limits to retirement plans will provide more opportunities for Americans to save effectively for retirement. Rules that reflect today's work and savings patterns will enable millions of Americans to save toward a secure future in their retirement years. Additionally, providing appropriately structured tax incentives, such as pension plan start-up and contribution tax credits for small

Bridget A. Macaskill, President and CEO, OppenheimerFunds, Inc.; Robert C. Pozen, President and CEO, Fidelity Management & Research Company; and Lawrence J. Lasser, President and CEO, Putnam Investment Management, Inc. address a wide range of emerging mutual fund issues at the General Membership Meeting.



employers, would increase plan formation. Simplifying the rules applicable to employer-sponsored plans would result in a greater number of plans, a higher rate of worker coverage, and increased individual savings.

In order to increase retirement savings, Congress must provide working Americans with the incentive to save and the means to achieve adequate retirement security. Current tax law, however, imposes numerous limitations on the amounts that individuals can save in retirement plans. Indeed, under current retirement plan caps, many individuals cannot save as much as they need to. One way to ease these limitations is for Congress to update the rules governing contribution limits to employer-sponsored plans. Increasing these limits will facilitate greater retirement savings

and help ensure that Americans will have adequate retirement income.

Congress continues to consider various provisions supported by the Institute to increase contribution limits to 401(k), 403(b), and 457 plans by stages to \$15,000, increase contribution limits for SIMPLE plans by stages to \$10,000; eliminate the 25 percent of compensation requirement for plans; increase pension portability; allow additional pension contributions for individuals 50 years and older; modify top-heavy rules; and reduce regulatory burdens.

Institute President Matthew P. Fink and Institute members Peter J. Smail, President of Fidelity Institute Retirement Services and John McCormick, President of TIAA/CREF Enterprises (l. to r.), testify in support of efforts to improve retirement security for all Americans, including simplifying rules governing retirement savings programs and expanding the availability of retirement savings programs.



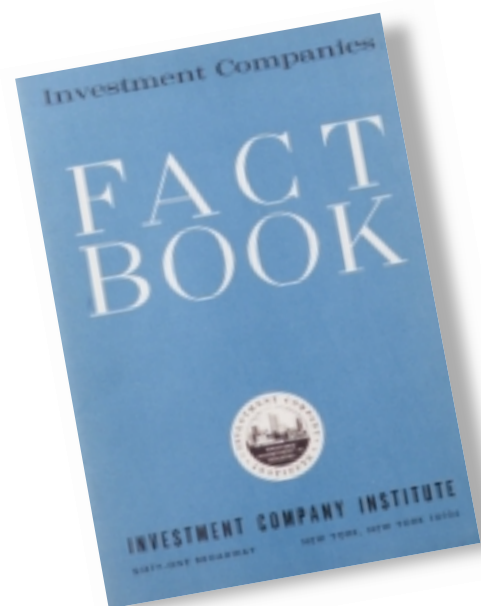
INDIVIDUAL RETIREMENT ACCOUNTS

The Institute has a long history of support for the IRA, which has become an important way for millions of Americans to save for retirement. In 1999, significant steps were taken as policymakers focused on the need to improve individual savings outside of Social Security. Legislation under active consideration proposes to increase the annual IRA contribution limit by stages to \$5,000; increase income limits on eligibility for Roth IRAs to \$100,000 from \$95,000 for individuals and to \$200,000 from \$150,000 for couples; increase to \$200,000 from \$100,000 the income limit on eligibility for couples to convert a regular IRA to a Roth IRA; and establish catch-up rules to allow additional IRA contributions by individuals 50 years and older.

SOCIAL SECURITY

While demographic trends will put an enormous strain on the Social Security program in the future, the Institute believes that Social Security's long-term health and status as a universal system must be maintained. The other two elements of the nation's retirement savings structure – individual savings and employer-sponsored retirement plans – should be strengthened to improve the nation's overall retirement savings health and reduce the strains on Social Security.

The Institute began publishing the Fact Book in the 1960s, detailing the size and scope of the growing investment company industry.



Promoting Investor Awareness and Disclosure

*F*ull disclosure is the touchstone of the mutual fund industry and serves millions of investors. Standardized tables and plain-English descriptions in mutual fund prospectuses help everyone, including investors and those who advise them, make informed investment decisions. Although the disclosure requirements for mutual funds are far more extensive than those of any other financial products, the Institute continues to support improvements that will aid investors in understanding the risks and rewards of mutual fund investing.



“We can never be complacent about the need to help our investors become knowledgeable about the issues and risks they encounter as they pursue their investment rewards,” cautions Institute Chairman John J. Brennan, also Chairman and CEO of The Vanguard Group, at the ICI General Membership Meeting in May.

“With 83 million Americans now investing in mutual funds, the industry remains committed to ensuring that shareholders have the resources to make informed decisions about their personal finances.”

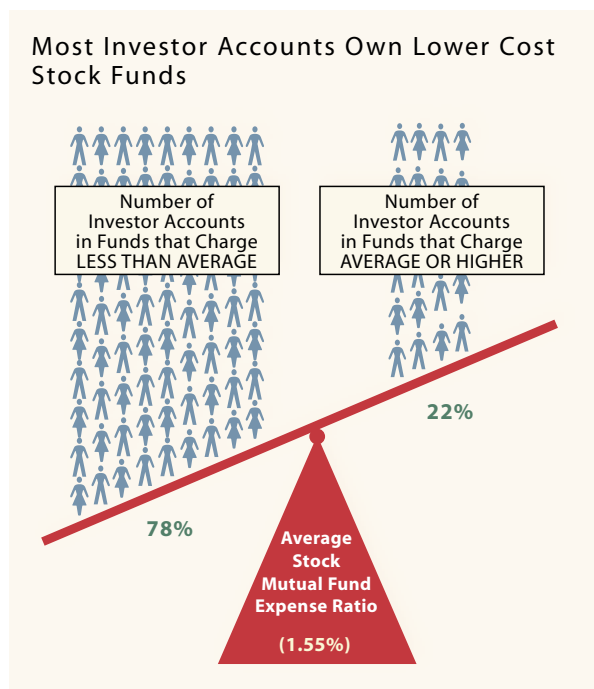
Institute Executive Vice President Julie Domenick

With 83 million Americans now investing in mutual funds, the effectiveness of funds' communications with investors is a matter of utmost importance. The mutual fund industry is committed to ensuring that shareholders are fully informed when making decisions about their personal finances and their futures. The industry and the SEC have devoted enormous attention over the years to improving standards governing fund prospectuses, annual and semi-annual shareholder reports, advertisements, and sales literature. The Institute has for many years also conducted an Investor Awareness Campaign.

FEE TRENDS AND DISCLOSURE

Mutual fund fees have long been the focus of public scrutiny. This scrutiny, in part, reflects the extraordinary level of fee disclosure mutual funds provide for shareholders. Mutual fund costs are subject to more exacting disclosure requirements than any comparable financial

product offered to investors. The industry has dedicated substantial resources to educating investors about fund fees and expenses. Indeed, evidence suggests that investors understand the impact of costs on investment performance. Institute research shows that 78 percent of equity fund shareholder accounts are invested in funds charging less than the industry's simple average.



In a series of studies, the Institute has taken a close look at shareholder cost trends. Institute research determined that the total cost of investing in mutual funds – sales loads and annual fees – has decreased significantly. Equity mutual fund costs decreased 40 percent between 1980 and 1998, while the costs of bond and money market funds dropped 29 percent and 24 percent, respectively, over the same period.

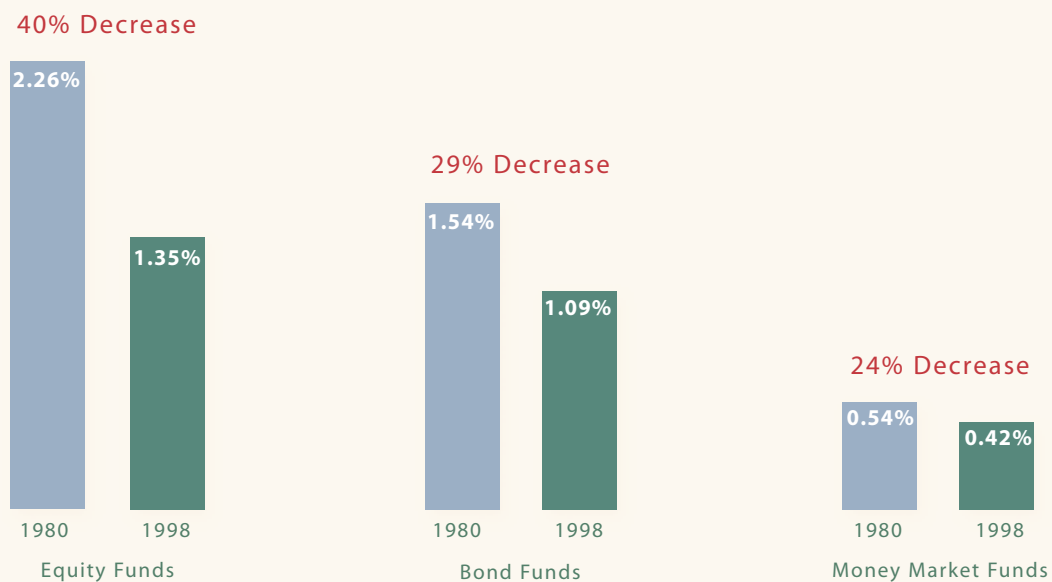
Additional research in 1999 explored economies of scale by examining the relationship between assets of individual equity mutual funds and their operating expense ratios. This study found that large equity funds generally have lower operating expense ratios than small equity funds. The study also determined that operating expense ratios of individual equity funds have generally

declined over time as their assets have grown. “These and other findings support the conclusion that a substantial majority of equity fund shareholders appear to have benefited from economies of scale,” Institute President Matthew P. Fink said.

AFTER-TAX DISCLOSURE

Ensuring a strong understanding of the tax consequences of fund investing is entirely consistent with the Institute’s long-standing support for initiatives to improve disclosure to investors. The Institute believes it is important that mutual fund investors understand the impact that taxes can have on returns generated in their taxable or ‘non-retirement’ accounts. Currently, mutual fund shareholders have more information about the impact of taxes on their investments than any other

Mutual Fund Fees Decrease Since 1980



investors. It is important for investors to be aware of the impact that taxes have on all types of investment returns, including the proceeds from the sale of individual stocks and the interest from savings or checking accounts.

In testimony in October before the House Subcommittee on Finance and Hazardous Materials, Institute President Matthew P. Fink supported legislation to direct the SEC to fashion new after-tax disclosure requirements. He also stressed that it is extremely important that any accounting of after-tax returns be accompanied by disclosure that informs investors of their appropriate use and inherent limitations. For example, investors will need to know that actual after-tax returns will vary from investor to investor, depending on each investor's federal and state tax rates and their own individual circumstances. Investors also must understand that after-tax return

numbers are not "predictive." A fund that has been highly tax efficient in the past could easily have significant taxable distributions in the future, and the size, scale, and timing of these distributions are sometimes beyond the control of the fund's manager. The Securities and Exchange Commission is proposing rules to require mutual funds to disclose after-tax returns based on a standardized formula. The Institute will continue to work with Congress and the SEC to achieve a result that will be most useful to mutual fund shareholders.

DOL FEE DISCLOSURE FOR EMPLOYERS

The Institute is committed to ensuring that employers are fully informed when making decisions about retirement plan services and investment choices. The mutual fund industry has long encouraged and supported the Department of Labor's efforts to improve cost disclosure for both 401(k) plan participants and plan sponsors. At the department's direction, the mutual fund, banking, and

With Reps. Paul E. Gillmor (R-OH) and Edward J. Markey (D-MA) looking on, Institute President Matthew P. Fink greets Rep. Christopher Cox (R-CA) prior to testifying before a House subcommittee on improving the disclosure of tax consequences of mutual fund investments. Fink said ensuring a strong understanding of the tax consequences of fund investing is consistent with the Institute's longstanding support for initiatives to improve disclosure to investors.



insurance industries worked together to develop a uniform disclosure form to help employers easily compare 401(k) plan expenses charged for different investment products and services. In September, the Institute joined Labor Secretary Alexis Herman and representatives of the banking and insurance industries to unveil the form, which the Institute believes will be a valuable resource to employers deciding which investment products and services to offer their 401(k) plan participants.

INVESTOR AWARENESS

The Institute has for many years conducted a campaign to improve investor awareness and to promote realistic expectations. The Institute expanded its Investor Awareness series in 1999 by producing a video, *Understanding Mutual Fund Fees*, a companion to the brochure of the same title, and by publishing a brochure, *Understanding the Role of Mutual Fund*

Directors, to explain the importance of directors in protecting shareholders' interests. These materials are among those distributed to the public through libraries, schools, the media, and at investor events, including the SEC Investors Town Meetings, the SEC's national Facts on Savings and Investing Campaign, the SEC's Diversity in Financial Services symposia to promote diversity in the financial services industry, and the Administration on Aging's financial literacy seminars. More broadly, the Institute participates with other investor awareness coalitions, including the American Savings Education Council, the Alliance for Investor Education and the Coalition of Black Investors.

In 1999, the Institute contributed to the SEC's National Facts on Savings and Investing Campaign by distributing the video *Understanding Mutual Funds* to 100 cable

Winners of the 12th Annual Journalism Awards competition, sponsored by The American University School of Communication and the ICI Education Foundation. From left: Ellen Schultz, *The Wall Street Journal*; Michelle Singletary, *The Washington Post*; Erik Pugh, *The (Durham, NC) Herald-Sun*; Jeffrey Laderman, *Business Week*; Scott Gurvey, *Nightly Business Report*; Tom Verde, *Marketplace Radio*; Martin Wattenberg, *SmartMoney Interactive*.



Between 1964 and 1968, the Institute launched several advertising programs, with print ads promoting mutual funds appearing in Life, Look, Newsweek, Time, US News and World Report, and Sports Illustrated.



television outlets nationwide for broadcast during the week and underwriting portions of the Morning Edition program on National Public Radio. The Institute also created a savings and investing quiz to help investors understand policy issues of industry interest. The quiz was placed on the Institute's public website, www.ici.org, which continued to enhance the Institute's ability to offer simplified and convenient access to our publicly available materials, and demonstrate our support for investor awareness.

Through the ICI Education Foundation, the Institute underwrites the annual Journalism Awards for Excellence in Personal Finance Reporting, which are presented at the General Membership Meeting. The award program is administered by American University's School of Communications and its National Center for Business and Economic Communication. To date, more than 86 journalists have received Awards for Excellence in Personal Finance Reporting for their work to help increase investor awareness of financial issues and products.



Michael D. McCurry, former press secretary to President Clinton (left) speaks with Institute Executive Vice President Julie Domenick; Institute Chairman John J. Brennan; and Terry Glenn, Executive Vice President, Merrill Lynch Asset Management at the General Membership Meeting.

Shareholder and Industry Profile

*M*utual funds are owned by 83 million investors from all walks of life. An Institute survey conducted in mid-1999 found that the typical mutual fund shareholder is middle-aged, middle income, and saving for retirement.

The Investment Company Institute moved from New York to new headquarters on K Street in Washington, DC in 1970, the same year in which the first comprehensive amendments were made to the Investment Company Act of 1940.



“Mutual funds are the primary investment vehicle of choice for most Americans.”

SEC Chairman Arthur Levitt

Mutual fund shareholders also are seasoned investors. For example, in a survey conducted in 1999, half of all shareholders had made their first mutual fund purchase before 1990 and more than one-third did so between 1990 and 1995. The typical mutual fund shareholder invests in mutual funds through employer-sponsored retirement plans; has \$25,000 invested in mutual funds; understands the key elements of investing in a mutual fund; and has long-term investment goals. Most shareholders are willing to take at least moderate risk for moderate gain and are not focused on short-term market fluctuations.

A significant research report, *Equity Ownership in America*, released by the Institute and the Securities Industry Association in 1999 found an estimated 49.2 million U.S. households, or 48.2 percent, own equities either in mutual funds or individually. Thirty-two percent own equities through employer-sponsored retirement plans and 36 percent own equities outside such plans. The typical equity owner is 47 years old, has household income of \$60,000, and household financial assets of \$85,000. Most equity owners are married, employed, and college graduates.

Views on Equity Investing by Owners of Stock Mutual Funds

(percent who strongly or somewhat agree)

I view my equity investments as savings for the long term:	97
I tend to follow a buy-and-hold investment strategy:	88
I am not concerned about short-term fluctuations in my equity investments:	84
I closely follow the value of my equity investments:	75
I tend to rely on advice from a professional financial adviser when making equity purchases and sales decisions:	66
I like to cash out my investments if I make a short-term profit:	19

Eighty percent are covered by employer-sponsored retirement plans, and 53 percent have Individual Retirement Accounts.

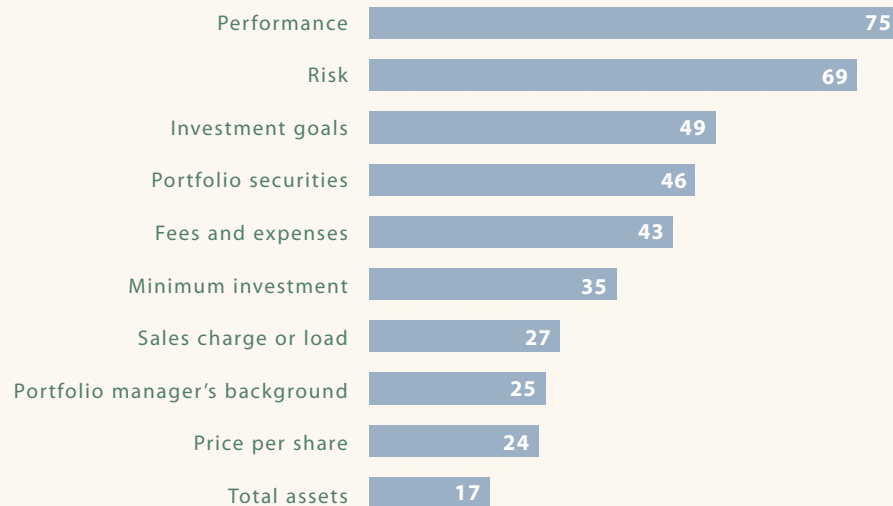
THE FINANCIAL MARKET ENVIRONMENT

Mutual fund shareholders faced a mixed environment in U.S. and world financial markets in 1999. In the United States, technology and communications stocks performed well, while other sectors of the stock market posted losses. More than half of all stocks experienced price decreases for the year. Furthermore, rising interest rates led to one of the largest annual declines in bond prices in 30 years. In the international arena, many foreign stock markets registered strong gains, particularly those in Asia.

Against this setting, mutual fund assets increased 24 percent to \$6.846 trillion. Investment performance, largely from rising stock prices, accounted for two-thirds of the asset growth. Net new cash flow of \$364 billion accounted for 28 percent of the increase in assets, with the remainder of the growth attributable to new funds. Net flows rose for equity funds in 1999 compared with 1998, but declined for other major investment objectives. The increase in net flow to equity funds, coming primarily from higher net purchases of equity funds by households, which continued selling, on balance, their direct stock holdings. Since 1994, households have sold more direct holdings than they acquired indirectly through mutual funds. This movement away from direct equity holdings continues to be an important source of growth for the mutual fund industry. It reflects, in part, the demand

Information Reviewed by Shareholders Before Making a Fund Purchase

(percent of survey respondents)



of shareholders for tax-deferred investment through employer-sponsored retirement plans and Individual Retirement Accounts.

MUTUAL FUND ASSETS AND FLOWS BY TYPE OF FUND

Equity Funds

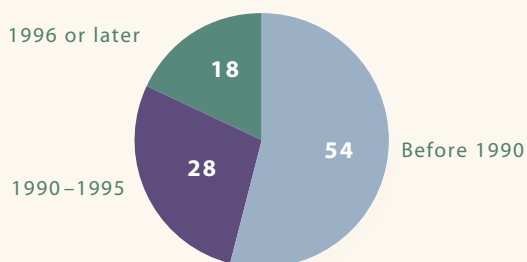
Assets in equity funds rose 36 percent in 1999 to \$4.042 trillion. Investment performance accounted for about four-fifths of the asset growth. Net new cash flow totaled \$188 billion, up 20 percent from \$157 billion in 1998. Domestic equity funds accounted for almost the entire net flow to equity funds. The monthly pattern of net new cash flows to equity funds suggests that fund investors did not redeem or curtail fund investments in anticipation of potential disruptions associated with Year 2000 computer concerns. Net new cash flows actually strengthened during the last three months of the year when such concerns

likely would have been most evident. In fact, the net flow of \$64 billion in the fourth quarter was the largest quarterly flow of the year and the highest since the third quarter of 1997.

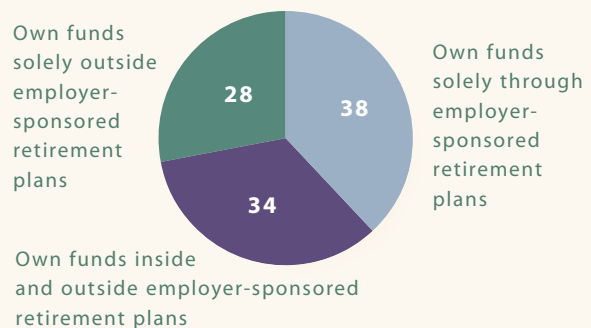
Money Market and Bond Funds

Assets of money market funds rose 19 percent in 1999 to \$1.613 trillion. Net new cash flow was \$194 billion, the second highest on record. Meanwhile, rising interest rates and falling bond prices combined to reduce bond fund assets by 3 percent in 1999 to \$808 billion. Intermediate- and long-term interest rates, which had reached 30-year lows in the fall of 1998, rose throughout 1999. In this environment, net new cash flow to bond funds, which typically declines when interest rates rise, fell to -\$5 billion in 1999 from \$75 billion in 1998. Net new flows began the year at a strong pace, totaling \$19 billion during the first quarter. As interest rates rose, monthly net flows turned

Year of First Equity Purchase
(percent of equity owners)



Mutual Fund Shareholders by Ownership
Inside or Outside Employer-sponsored
Retirement Plans
(percent)



negative and totaled -\$24 billion over the last three quarters. The level of net outflows increased in the last quarter, as many investors likely sold funds for tax purposes, as they did in 1994 when many bond funds also posted losses for the year.

Hybrid Funds

Assets in hybrid funds – those investing in both stocks and bonds – rose 5 percent in 1999 to \$383 billion. The modest asset growth resulted from fund performance, which was held down by the decline in bond prices, and from a net outflow of \$12 billion, the first annual outflow since 1988. Net new cash flow turned negative after the stock market sell-off in the summer of 1998 and remained negative throughout most of 1999. The decline in net flow reflected an increase in redemptions and exchange redemptions rather than a slowdown in new sales, which remained about unchanged in 1999.

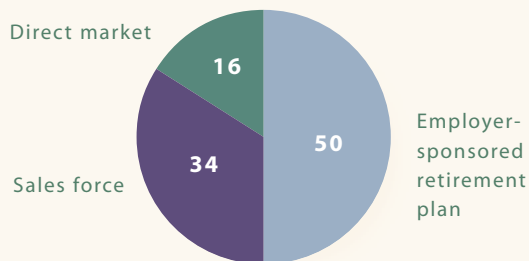
MUTUAL FUNDS AND THE RETIREMENT MARKET

Retirement plans, including IRAs, plans for the self-employed, and 401(k) and other employer-sponsored plans, hold about one-third of all mutual fund industry assets. The share of mutual fund assets in retirement plans, \$1.86 trillion at year-end 1998 the latest year for which statistics are available, has remained fairly stable at 34 percent in recent years. However, funds hold a relatively small percentage of the nation's retirement assets. Of the \$10.9 trillion of assets in U.S. retirement plans, the \$1.86 trillion held by the mutual fund industry represents approximately 17 percent.

Institute research in 1999 continued to shed light on how American workers invest for retirement. In a collaborative effort, the Institute and the Employee Benefit Research

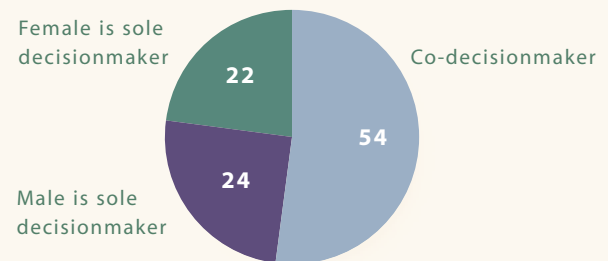
Shareholders' Primary Mutual Fund Purchase Channel

(percent who designate one channel as primary)



Investment Decisionmaker in Fund-owning Households

(percent)



Institute produced the most comprehensive database on 401(k) plan participants ever compiled. Among other findings, the study found that the average account balance, minus plan loans, for all participants totaled \$47,004 at yearend 1998. Almost three-quarters of plan balances are invested directly or indirectly in equity securities, and asset allocation in 401(k) plans varies in age-appropriate ways. For example, fixed-income investments draw roughly one-fifth of the assets of those in their 20s, compared to nearly 41 percent for those in their 60s. The study also found that 401(k) plans can provide substantial retirement income for workers with long tenure at their current employer. For example, workers in their sixties with at least 30 years of job tenure at their current employer have an average 401(k) account balance of \$185,474. Workers in their fifties with 20 to 30 years of tenure at their current employer have an average 401(k) account balance of about \$135,000.

Retirement assets in mutual funds, including employer-sponsored defined-contribution plans and IRAs, increased 23 percent in 1998. The growth was primarily the result of investment performance, which accounted for more than two-thirds of the increase. Mutual funds assets held in IRAs, including “traditional” IRAs, Simplified Employee Pension (SEP) IRAs, SIMPLE IRAs, and the newer Roth IRAs, stood at \$930 billion at the end of 1998. This figure represents 44 percent of the \$2.1 trillion IRA market. Fund assets in employer-sponsored defined-contribution plans totaled \$931 billion in 1998. Nearly 70 percent of this growth was the result of investment performance, with the remainder coming from net new investments. Mutual fund assets held in 401(k) plans in 1998 accounted for \$593 billion or nearly two-thirds of all mutual fund defined-contribution plan assets.

The Institute moved to the National Geographic Building on M Street in Washington, DC in 1984, the same year in which the Institute's first Investment Adviser Conference was held.



Institute Governing Groups

The Institute's current headquarters in Washington, DC.



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D

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DLB Fund Group
DLJ Asset Management Group

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Domini Social Investments, LLC
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Driehaus Capital Management, Inc.

E

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Eastcliff Funds
Eaton Vance
Eclipse Funds
Elite Group, The
Endeavor Management Co.
Enterprise Group of Funds, Inc.
EQ Advisors Trust
Evergreen Funds

F

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Federated Investors
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First Eagle Funds
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Golf Associated Fund
Govett Funds
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Great Hall Investment Funds, Inc.
Green Century Funds
Greenspring Fund
Groupama Asset Management
Growth Fund of Washington
Guardian Investor Services Corporation
Guinness Flight Investment Funds

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Hartford
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Labrador Mutual Fund
Lake Forest Funds
Lazard Asset Management
Lebenthal
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Liberty Funds Distributor/Liberty Financial
Light Index Investment Company
LKCM Funds
London Pacific Life and Annuity Company
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LSA Variable Series Trust
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M

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MONY
Morgan Keegan

Morgan Stanley Dean Witter Advisors Inc.
Morgan Stanley Dean Witter Investment
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Mosaic Funds
Muhlenkamp
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Mutual of America
Mutual Selection

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Nuveen
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O

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Olstein Funds
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OppenheimerFunds/MassMutual
Orbitex Management, Inc.
O'Shaughnessy Capital Management, Inc.

P

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Pacific Advisors Fund Inc.
PaineWebber
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Payden & Rygel
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Profit Funds Investment Trust
ProFunds
Progressive Investment Management
Protective Investment Company
Providentmutual Investment Mgmt. Co.
Prudential Mutual Funds
Public Service Investment
Purissima Funds, The
Putnam Funds

Q

Quant Group of Funds
Questar Funds

R

R.O.C. Taiwan Fund
Rainier Investment Management
Republic Funds
Righttime Family of Funds
RISA Investment Advisers
RNC Mutual Fund Group, Inc.
Robinson Capital Management, Inc.
Rochdale Investment Management
Rodney Square
Roulston & Co.
Royce Funds, The
RS Investment Management
RWB Advisory Services
Rydex Series Trust

S

SAFECO
Saturna Capital Corporation
Schafer Capital Management
Schroder Fund Advisors Inc.
SchwabFunds
Schwartz Investment Counsel, Inc.
SCM Investment Trust
Scudder Kemper Investments
Security Benefit Group
Security Capital
SEI Investments
Seligman
Sentinel
Sentry
SG Cowen Securities Corporation
Sheffield Funds, The
SIFE
Sit Mutual Funds
Skyline Funds
SM&R
Smith Breeden Associates
SoGen Funds, The
SSB Citi Asset Management

SSgA Funds
STAAR Investment Trust
Standish Funds
State Farm
State Street Research
Stein Roe & Farnham Incorporated
StockJungle.com
Stratton Mutual Funds
Stratus Funds
Strong Funds
SunAmerica Group
Swiss Helvetia Fund, Inc., The

T

T. Rowe Price
Tax Free Fund of Vermont
TCW Galileo Funds, Inc.
TD Waterhouse Asset Management, Inc.
Third Avenue Funds
Thomas White Funds Family
Thompson, Plumb & Associates
Thurlow Funds, The
TIAA-CREF
Timothy Partners, Ltd.
TIP Funds
Tocqueville
Touchstone Family of Funds
Transamerica Investment Services
Transamerica Investors, Inc.
Tweedy, Browne Fund Inc.

U

U.S. Global Investors Funds
U.S. Trust Company
UBS Brinson Funds, The
Unified Funds, The
Uniplan, Inc.
United Asset Management
United Funds
United Management Company
Universal Capital Investment
USAA

V

Value Line
Van Deventer & Hoch
Van Eck
Van Kampen Investments Inc.
Vanguard Group, The
Vantagepoint Funds
Venture Lending & Leasing, Inc.
Viking Fund Management
Villanova Capital
Volumetric

W

Wade Fund
Wanger Asset Management, L.P.
Wasatch Advisors
Wayne Hummer
Weiss Peck & Greer
Weitz & Company
Wells Asset Management
Wells Fargo
Weston Financial Group
William Blair Mutual Funds, Inc.
Williamsburg Investment Trust
WM Group of Funds
Woodlawn Funds Trust
WWW Advisors, Inc.

Y

Yorktown Management

Z

Z-Seven Fund

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