

INVESTMENT COMPANY INSTITUTE
ACCOMPLISHMENTS AND RECENT ACTIVITIES

MAY 2004

ICI'S MISSION AND FUNDING

The Investment Company Institute was formed in 1940, at the suggestion of the United States Securities and Exchange Commission (“SEC”), to represent mutual fund organizations on regulatory and legislative issues. The Institute’s membership includes more than 8,000 mutual funds, their investment advisers and principal underwriters. Its mutual fund members manage more than 95% of total mutual fund assets.

Recognizing that the Institute’s work is consistent with and promotes the interests of fund shareholders, on October 5, 2000, then SEC Chairman Arthur Levitt stated: “Time and again, the ICI has supported laws and regulations designed to protect fund investors. It has established tough voluntary standards that go well beyond requirements of the law, creating best practices for personal investing and providing additional guidance for mutual fund directors.”

Approximately 80% of the Institute’s annual income is derived from dues paid by members. (The remaining 20% of income is derived from fees for publications, conferences and investments.) More than 90% of the Institute’s annual expenses are devoted to its core mission—representation of mutual funds, their investors, directors and advisers. The remainder of the Institute’s resources are devoted to supporting various conferences and other fee-based surveys that help industry professionals and fund directors keep current on topics of importance to fulfilling their duties to fund shareholders.

The Institute’s mission is to advance the interests of mutual funds and their shareholders. This mission involves the Institute in a wide range of regulatory, legislative and business matters, some of which are highly visible—such as advocating for increased retirement savings opportunities and improved tax treatment of mutual fund distributions. However, much of the Institute’s work rarely draws public attention, yet is nonetheless extremely important to mutual funds and their investors—for example, helping mutual funds and their advisers comply with myriad regulations, laws and securities industry initiatives that arise each year. In the long run, most of the Institute’s work directly benefits mutual fund shareholders or helps them indirectly by enabling fund advisers and underwriters to work more effectively on their behalf. The examples described in this paper illustrate both parts of the Institute’s work.

The first part of this paper lists major Institute accomplishments over the past 30 years. These accomplishments have provided mutual fund investors with new investment vehicles, such as tax-exempt mutual funds; enhanced savings opportunities, such as expanded IRA and 401(k) limits; and enhanced disclosure, such as standardized fund performance.

The second part of this paper summarizes recent Institute activities in a broad range of regulatory, legislative and business matters. Each year, ICI devotes considerable resources to ensuring that regulatory, legislative and industry initiatives strengthen investor protections and enhance the structural integrity and efficiency of mutual funds to serve investor needs.

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I. MAJOR INSTITUTE ACCOMPLISHMENTS 1974–2004

1974 – Creation of IRAs

The Institute worked for legislation authorizing the creation of the first Individual Retirement Accounts as a means for workers not covered by employer-sponsored retirement plans to help secure their future. By the end of 2002, Americans had invested \$2.3 trillion for retirement through IRAs.

1976 – Creation of Tax-Exempt Funds

The Institute obtained legislation permitting the creation of tax-exempt funds. By the end of 2003, Americans had invested \$622 billion in tax-exempt funds. These funds provide investors with tax-free income and are a significant source of capital to state and local governments for investment in infrastructure, schools, hospitals and other critical municipal projects.

1977 – Reduction of SEC Registration Fees

As requested by the Institute, the SEC permitted funds to subtract redemptions of fund shares from new sales when computing SEC registration fees. Over the years, this has saved mutual fund shareholders billions of dollars. In 2003 alone, long-term mutual funds saved \$100 million and money market funds saved \$900 million in registration fees.

1979 – Advertising Fund Performance

As requested by the Institute, the SEC permitted mutual funds to advertise their past performance. This regulatory change promoted competition by giving no-load mutual funds the means to directly inform individual investors about the potential investment returns of mutual funds.

1980–1981 – Overcoming Attacks on Money Market Funds

The Institute successfully worked to defeat legislation in more than 20 states aimed at prohibiting money market funds. At the end of 2003, Americans had invested \$2.1 trillion in these funds, which have become the investment of choice for individuals and institutions seeking a short-term low risk investment vehicle for their money.

1981 – Creating the Universal IRA

The Institute successfully worked to obtain legislation permitting all workers to have tax-deductible IRAs. Prior to this legislation, Americans contributed approximately \$3 billion a year to IRAs. During the period of expanded availability (1982 through 1986) Americans contributed on average \$34 billion per year to IRAs, thus helping them create a more secure retirement.

1983 – Simplifying Mutual Fund Prospectuses

The Institute supported an SEC initiative that shortened and simplified the mutual fund prospectus. By making the disclosures more readable, the simplified prospectus helped investors become better informed.

1986 – Simplifying Investor Transactions

Under ICI leadership, the mutual fund and brokerage industries, with assistance from the National Securities Clearing Corporation, created a centralized, automated clearance and settlement service—Fund/SERV—which quickly became the standard for communicating investor transactions between distribution intermediaries and mutual fund transfer agents. Fund/SERV has saved mutual fund shareholders hundreds of millions of dollars in processing costs.

1988 – Standardized Investment Performance Disclosure

Under ICI leadership, a task force of mutual fund sponsors developed standardized formulas to compute mutual fund yield and total return. These standards enhanced uniformity among funds and enabled fund investors to compare performance among mutual funds. The SEC based its 1988 rule on the recommendations of this task force.

1988 – Affordable and Accessible Directors and Officers Insurance

The Institute created a captive insurance company, ICI Mutual Insurance Company (ICIM), to write directors and officers, errors and omissions and fidelity bond insurance for mutual funds, their directors and advisers. The creation of ICIM stabilized the availability and lowered the cost of insurance coverage mutual funds maintain. ICIM also serves as a fraud clearinghouse that protects funds and their shareholders against potential losses caused by criminal activity.

1991 – Enhancing Credit Standards for Money Market Funds

At the Institute's request, the SEC tightened the standards for permissible investments by money market funds. These new rules reduced risks to money market fund investors by enhancing the credit quality of portfolio holdings.

1994 – Industry Best Practices on Personal Investing by Fund Personnel

A Blue Ribbon Task Force of Institute members issued best practice recommendations on personal investing by fund personnel to guard against conflicts of interest. In a voluntary effort to prevent such conflicts, the Institute's Board of Governors called on every mutual fund to adopt the recommendations that called for a series of strict policies and procedures in this area.

1995 – ICI Begins Formal Educational Programs for Fund Directors

The Institute launched a major educational program for fund directors, including annual conferences, workshops, regional meetings and publications. The program helps fund directors remain informed and enhances their ability to fulfill their obligations to fund shareholders. Since 1998 (the earliest year for which statistics are available) more than 1,400 fund directors have participated in these programs.

1996 – Uniform Federal Regulation of Mutual Funds

The Institute helped secure legislation preempting inconsistent and often conflicting state regulation of mutual funds, while fully preserving state authority to prosecute fraud and abuse. This legislation eliminated conflicting, duplicative and inconsistent regulatory requirements that increased fund costs, hindered innovation and diverted scarce state government resources away from enforcement priorities where state action is required to protect investors.

1996 – Simplified IRAs for Small Businesses

The Institute supported passage of the Small Business Job Protection Act which created SIMPLE IRAs and facilitated the creation of retirement savings plans for small businesses. At the end of 2003, ICI estimates there were approximately 375,000 SIMPLE IRA plans with 1.7 million Americans participating in them.

1997 – Simplifying Mutual Fund Taxation – Repeal of the 30% Test

The Institute obtained repeal of a tax provision that limited mutual fund portfolio management activities. The repeal of the 30% test modernized the Internal Revenue Code by removing restrictions that hampered a fund's ability to take advantage of opportunities to improve investment returns for fund shareholders.

1997 – Creation of Roth IRAs

The Institute supported passage of the Taxpayer Relief Act, which allowed Americans to make after-tax contributions to Roth IRAs, thus creating another means for working Americans to save for retirement. In 2000, the IRS estimated that \$11.5 billion was contributed to Roth IRAs. This exceeded the amount contributed to traditional IRAs.

1998 – Disclosure Simplification and Plain English Initiatives

The Institute suggested and supported a host of SEC disclosure reforms, including new fund "profile prospectuses," designed to easily convey the most essential information about a fund. The reform measures also encouraged the use of plain English in fund prospectuses, and improved risk disclosures to help investors better understand their fund investments.

1999 – Opposing Efforts to Weaken Investor Protections

The Institute successfully opposed legislation that would have repealed core anti-self-dealing provisions of the Investment Company Act of 1940, thus allowing broker-dealers to sell securities to funds they sponsor. The Institute vigorously and successfully argued that the proposal was too broad and could lead to conflicts of interest detrimental to fund shareholders.

1999 – Industry Best Practices for Fund Directors

An Advisory Group of Institute members issued a series of 15 best practices in fund governance. In a voluntary effort to enhance fund governance, the Institute’s Board of Governors urged every mutual fund to adopt the recommendations that enhanced the independence and effectiveness of fund directors in fulfilling their responsibilities to shareholders. The Council of Institutional Investors, a leading proponent of corporate governance, called the Institute’s best practices “far-reaching, extending beyond current legal requirements, industry practices, and in some cases ... surpassing practices currently endorsed by the Council and other groups.”

2001 – Enhancing and Simplifying Retirement and Education Savings Plans

The Institute successfully supported legislation increasing tax-preferred contributions to IRAs and 401(k) plans, permitting catch-up contributions to these plans for older participants, and enhancing “portability” of retirement assets. These measures help Americans better prepare for their retirements, and provide greater control of their retirement assets. The Institute also supported increased contribution limits for Coverdell Education Savings Accounts.

2002 – Supporting Appropriate Accounting Board Fees

The Sarbanes-Oxley Act requires issuers of securities, including mutual funds, to pay fees to support two accounting boards. As recommended by ICI, mutual funds support these efforts to strengthen accounting and auditing standards, but do so by means of registration fees that are substantially lower than for operating companies. The resulting savings to mutual funds and their shareholders exceeds \$35 million per year.

2003 – Fair Taxation of Dividends and Capital Gains

The Institute supported and worked for provisions in the 2003 tax legislation that provides mutual fund shareholders with the full benefit of lower tax rates on dividends and capital gains. The Institute’s work addressed complicated aspects of the legislation and helped ensure that its tax benefits would “flow-through” to fund shareholders.

II. RECENT INSTITUTE ACTIVITIES

A. Investor Protections Under the Federal Securities Laws

Since its founding in 1940, the Institute has supported tough, effective SEC regulation to ensure that investor protections under the Investment Company Act and other securities laws maintain pace with changes in financial markets and technology. Some examples of recent Institute positions that protect fund shareholders follow.

Mutual Fund Trading Scandals

1. In response to the recent revelations of trading scandals, the Institute called for measures to protect fund shareholders — notably a hard 4 p.m. cutoff for the receipt of purchase and redemption orders to address late trading, and a uniform minimum 2% redemption fee on short-term trades to address market timing. The Institute also urged its members to clarify or amend their codes of ethics to require oversight of trades by fund company employees in their companies' funds.
2. In response to the scandals, the SEC has proposed and/or adopted reforms that the Institute suggested years ago. In 1994, the Institute urged the SEC to adopt a rule requiring every mutual fund to have an internal compliance system and a compliance officer. In December 2003, the SEC adopted a similar rule. In 1995, the Institute urged the NASD — and, in 2000, urged the SEC — to require broker-dealers to disclose revenue-sharing arrangements between funds and brokers. Both the SEC and NASD recently proposed these rules.
3. The Institute has looked beyond the issues of late trading and market timing and called for a series of reforms to address other areas of possible abuse that could harm funds and their shareholders, including a total prohibition on the use of directed brokerage and a major curtailment in the use of soft dollars for research. These Institute suggestions have been incorporated in pending legislative and regulatory proposals.

Enhanced Investor Disclosure

The Institute has supported a long list of other recent SEC and NASD initiatives, including enhanced readability of fund prospectuses and shareholder reports, standardized disclosure of after-tax returns in prospectuses, standardized disclosure of fund expense information in shareholder reports, and improved fund advertisements that include expense ratios and ensure investor access to more current performance data.

Fund Best Practices and Compliance

Although the Institute is not a self-regulatory organization, it has consistently published best practices, discussed in Part I, and compliance guidelines in areas such as valuation procedures, anti-money laundering, brokerage allocation practices and side-by-side management of mutual funds and hedge funds.

Mutual Funds as Investors

1. Mutual funds constitute a large portion of the “buy-side” of world capital markets. Along with other institutional and individual investors, the Institute has called for and supported a number of initiatives that enable funds to trade more efficiently on behalf of their shareholders, which would result in lower costs for fund investors and strengthen protections available to mutual funds.
2. In recent years, the Institute (a) urged the NYSE to improve its trading systems; (b) recommended that the NYSE, AMEX and Nasdaq require option programs to be approved by shareholders; and (c) submitted comments supporting a European Commission action plan, *Modernizing Company Law and Enhancing Corporate Governance in the European Union*, which outlines priorities for improving the rights of shareholders, including U.S. mutual funds, in the European Union. The Institute has for many years been active in the International Corporate Governance Network to improve minority shareholder rights abroad.

Regulatory Oversight

Historically, the Institute has consistently expressed support for Congress to provide increased SEC resources to oversee mutual funds and ensure investor protection.

B. Fund Governance

The Investment Company Act creates a unique corporate governance system for mutual funds and their shareholders under which fund boards must have a majority of independent directors who act as “watchdogs” in protecting against conflicts of interest. The Institute actively encourages strong mutual fund governance in a number of ways, as described below.

Independent Directors Council

The Institute recently established the Independent Directors Council to advance the education of, communication with and development of policy positions by independent fund directors. The Council continues to offer and enhance the robust series of educational programs and local chapter meetings for fund directors initiated by the Institute in 1995. Approximately 3,000 independent fund directors of ICI member mutual funds are invited to participate in the activities of the Council.

The Managing Director of the Council and the Institute’s President regularly attend fund board meetings to provide updates on legislative and regulatory developments that impact the industry and fund governance.

Fund Governance Survey

In 2003, the Institute completed its fifth industry-wide survey of independent director and board practices. This survey provides an in-depth look at the range of mutual fund board practices and director compensation. Fund directors use this survey to help assess their governance practices.

C. Improved Tax Treatment of Fund Investors

The Institute's tax agenda is centered on support for measures to provide mutual fund shareholders with tax treatment comparable to that received by direct investors in securities (*i.e.*, pass-through treatment, with taxation of a fund's income and capital gains taxed only once, at the investor level). Some of ICI's recent tax efforts at the federal, state and international levels include working (a) for passage of pending legislation that would permit mutual fund shareholders to defer the payment of tax on capital gains that are automatically reinvested in additional fund shares until the investor chooses to redeem fund shares; (b) to oppose state legislative proposals (such as in Pennsylvania, New Jersey and Kentucky) to impose any tax directly on funds or fund shareholders who are not residents of the state; (c) with the U.S. and foreign governments to ensure that U.S. shareholders in funds investing in foreign securities receive the same tax benefits that are received by U.S. investors who acquire these securities directly.

Equal Tax Treatment of Fund Portfolio Holdings

The Institute has actively sought clarification of various tax requirements governing the treatment of fund portfolio holdings so that particular types of securities (*e.g.*, repurchase agreements, Treasury Inflation Protected Securities, refunded municipal bonds and synthetic municipal instruments) do not inadvertently incur fund-level taxation, which would lower investor returns. The Institute further sought clarification that certain types of activities (such as certain fund mergers) do not inadvertently result in accelerated shareholder-level taxation, which would also lower investor returns.

Investor Tax Compliance

The Institute has worked to support securities industry compliance initiatives, such as facilitating the electronic delivery to brokers and other intermediaries of year-end tax information in a standardized format so that investors can receive prompt, accurate year-end tax information on IRS Form 1099.

D. Enhanced Retirement and Education Savings Opportunities for Investors

The two principal reasons Americans invest in mutual funds are to save for their retirement and their children's education. The Institute has consistently supported and worked for legislation and regulation aimed at helping fund shareholders achieve these goals. ICI's most recent efforts have been directed toward the following.

Savings Incentives

The Institute has supported (a) pending legislation to: increase the age at which individuals must begin taking minimum distributions from their IRAs and 401(k) plans; accelerate increases in contribution limits to 401(k) plans; and make permanent the retirement and education savings incentives enacted in 2001; (b) the Bush Administration's proposals to further simplify and enhance retirement and education savings vehicles; (c) initiatives to enhance small employer retirement plan coverage and savings; and (d) legislative efforts to ensure that states provide the same tax-free treatment for withdrawals from 529 plans that is provided at the federal level.

Investor Education

The Institute (a) supported and assisted the Department of Labor in developing a model 401(k) fee disclosure form for employers; (b) supports greater disclosure of investment information to 401(k) plan participants; and (c) supports expanded opportunities for plan participants to receive investment advice.

Investor Protections

The Institute supports Department of Labor guidance that helps retirement plan fiduciaries restrict market timing by plan participants that may be harmful to shareholders.

E. Other Initiatives

Mutual funds and their shareholders are affected by a wide range of financial services regulatory and legislative initiatives, such as the Patriot Act, broad based investor education initiatives such as increasing financial literacy among minorities and general securities industry initiatives such as streamlining the way investors interact with mutual funds. As described below, the Institute has supported mutual funds in a number of these areas, many of which no single group of mutual funds could have addressed on their own.

Anti-Money Laundering – In 2003, the Institute worked closely with the SEC and the Department of the Treasury to develop the new anti-money laundering rules called for by the Patriot Act. The rules that were implemented enable investors to execute transactions with their mutual funds in a streamlined manner and at a significantly reduced cost, while still meeting the rigorous customer identification procedures called for by the Patriot Act.

Privacy – The Institute actively represents funds and their shareholders on a broad range of federal and state privacy issues. In particular, the Institute works to ensure that privacy initiatives maintain rigorous consumer protections and also acknowledge the unique structure of funds. This effort is necessary to allow funds to perform integral shareholder transactions and deliver other expected shareholder services in an effective, timely and cost-efficient manner.

Investor Education – In the early 1970s, the Institute began publishing brochures and other materials to enhance investors' and brokers' understanding of mutual funds. In the 1990s, these efforts evolved into ICI's active support and participation in SEC Chairman Arthur Levitt's Town Hall Meetings, which were conducted in cities across the country to help investors better understand all forms of investing, including mutual funds. Most recently, through the ICI Education Foundation, the Institute along with its partners, the National Urban League and the Hispanic College Fund, Inc., created the *Investing for Success* program, which provides investor awareness materials, workshops and interactive web courses focused on minority investors.

Understanding Mutual Fund Investor Behavior – The Institute’s Research Department conducts studies on fund shareholder behavior, including the regular redemption activities of individual shareholders and shareholders’ reactions to market declines. These studies have informed policymakers and helped prevent the adoption of unwise limitations on shareholders’ right to redeem. The Research Department also studies the behavior of participants in 401(k) retirement plans, which indicates that generally participants are making sound asset allocation decisions.

Accurate Information About Daily Fund Values – The Institute sponsors a forum for the Nasdaq’s Mutual Fund Quotation Service, market data vendors, the media and mutual funds to develop efficient processes to disseminate daily fund share prices so that investors can learn the value of their mutual fund holdings in daily newspapers and through numerous electronic networks. The Institute provides daily coordination to respond to delays that occur within the price dissemination process so that investors receive uninterrupted information flow about the value of their holdings.

Competitive Transfer Agent Fees – The Institute sponsors a biennial Study of Transfer Agent Trends and Billing Practices. The Study provides fund boards with benchmark information to compare their fund’s transfer agent arrangements with those in a peer group.

Compliance Education for Mutual Fund Professionals – Annually, the Institute sponsors several conferences, workshops and educational forums designed to help mutual fund legal, accounting and operations professionals enhance their knowledge of current industry topics so they can better meet mutual fund investor needs. The Institute also offers web-based training programs that enable investor service representatives to better serve mutual fund investors.



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