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Less and More: A Better Approach for Informing Fund Investors

ICI President's Remarks at the Mutual Funds and Investment Management Conference

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A Better Approach for Informing Fund Investors

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Good morning and a very hearty welcome to our 43rd Mutual Funds and Investment Management Conference. Special thanks to Amy Doberman, our Conference Chair; to all the members of our conference advisory committee, and to Jack Lockridge of the Federal Bar Association, for their important contributions to this program. I also am most grateful that SEC Commissioner Paul Atkins is here as this morning’s keynote speaker.

We convene this conference during an unusual and highly challenging period for our financial markets. Conference panels will consider some of the implications of all this for our industry and our investors. Let me say simply this: We are certainly not immune to the ups and downs of the securities markets. But our kind of fund investing – transparent, highly diversified, with very limited leverage, and subject to strict pricing disciplines – is designed to weather such storms better than most investment vehicles. As fiduciaries, our concern first and last should be to assist our shareholders, and help them achieve the long-term financial goals for which they invest in our funds.

I have one large subject that I want to address today – what the SEC's November 2007 proposing release terms the "Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies"!

Wow! How's that for plain English!

But don't let the title fool you – there is something momentous underway here. Something very important for our shareholders. Something for which Chairman Chris Cox, Paul Atkins and the other members of the Commission, and the responsible SEC staff, particularly Buddy Donohue, Susan Nash, and their colleagues in the Division of Investment Management, all deserve our thanks and congratulations. It took a lot of hard work and dedication to move the proposal forward to this stage. Maybe, just maybe, we are nearing the end of a long march toward fashioning a disclosure document that does more than disclose – one that, in fact, informs the investor.

I don't have to tell this audience what a long pedigree the principle of "disclosure" has in our securities laws. It is emblematic of the very philosophy that brought the SEC into being, and it has informed the agency's work most closely ever since.

In the 1932 speech where he promised "a new deal for the American people," Franklin Roosevelt also spoke of "letting in … the light of day on issues of securities … offered for sale to the investing public." As Joel Seligman observed in his landmark study The Transformation of Wall Street, a "primary enduring mission of the SEC has been to compel disclosure of data by firms involved in the securities markets." Over time, the SEC's disclosure philosophy became so well established that it was "generally regarded as the appropriate or inevitable method of regulating corporate finance."

Both the SEC and our industry focus sharply on what mutual funds must "disclose" – that is, make public in fund prospectuses, shareholder reports and otherwise. But disclosing is quite different from informing. To disclose means to reveal or tell, whereas to inform means to instruct or educate. Information is knowledge communicated.

Disclosing the facts and informing the investor – for a long time, these have been shared purposes of securities regulation, at least where mutual fund prospectuses are concerned. But so much has changed.

Financial markets and products have become more complex. The subjects of interest to various market participants have expanded. The investor class has grown to embrace a larger and larger portion of the population. Individuals have assumed greater responsibility for personal financial management. And the Internet has brought us new and unforeseen ways to communicate with investors.

As we have witnessed these developments and others, the tension between fully disclosing and effectively informing has become ever more apparent. In a process that my distinguished predecessor Matt Fink labeled "disclosure creep," the SEC – often for good and sufficient reasons – has required funds to make more and more and still more detailed information available to investors. Fund lawyers piled on, too, to make sure that nothing arguably material would be omitted. But all that mass of disclosure has made the mutual fund prospectus increasingly ill-suited to the purpose of informing investors – that is, communicating the most useful knowledge about a fund.

Over the years, there have been valiant attempts to resolve this tension. In 1982, the SEC expressed the view that “under present requirements, mutual fund prospectuses are not effective disclosure documents for most investors because they are too long and complex.”

So it proposed, and the following year adopted, a new two-part disclosure system that required funds to deliver to investors a simplified prospectus, with a new Statement of Additional Information available free, upon request – the same prospectus-and-SAI format that we have today. But over time, this excellent idea gradually fell victim to “disclosure creep,” and the so-called “simplified prospectus” became bloated and unwieldy.

So, by the mid-1990’s, the quest for meaningful reform in this area was again at the top of ICI’s regulatory agenda. In 1996, our research staff conducted our first survey of mutual fund shareholders about the issue. We learned from it – no surprise here – that the existing prospectus was little used and poorly adapted to the needs of most investors. And we documented investors’ strong preference for a shorter document, containing specific kinds of information and graphic presentation. The SEC’s project to improve fund disclosure, launched under Chairman Arthur Levitt, culminated in 1998 when the SEC adopted sweeping amendments to the full prospectus and authorized the voluntary use of a short-form disclosure document called a Fund Profile.

Unfortunately, the Fund Profile never lived up to its early promise. The Commission provided no insulation from shareholder lawsuits complaining that the document – by design, of course, a profile – omitted some information. The Fund Profile also required quarterly updating of performance data, which would have been expensive and time-consuming. And, funds were still mandated to deliver a statutory prospectus with the transaction confirmation. As a result, fund companies chose not to use the Profile. But the effort was not altogether in vain – its legacy can be found today in the risk-return summary at the beginning of every prospectus.

Despite the disappointing experience with the Fund Profile, we have remained convinced that a better way can be found to serve the interests of fund shareholders. And we have recognized, as does Chairman Cox, that the intervening years have wrought phenomenal changes in the way Americans access and use information – changes of enormous relevance to our system of disclosure.

In October 2006, ICI released the results of a survey on shareholders’ Internet usage. It found that Internet access was nearly universal among fund-owning households. Even older fund owners were in the game; about three-quarters of those over 65 were Internet users, as opposed to about two-thirds a year earlier.

These findings amply demonstrated the exciting possibilities the Internet presents for a have-your-cake-and-eat-it-too solution to the disclosure conundrum. No longer is it necessary to choose between less or more, between what's in and what's out, as with the Fund Profile. It is possible to have less and more. To put in the hands of millions of average investors what they clearly want and need – a short, high-quality document that communicates the most useful knowledge about a fund. And to assure 24/7 access for one and all, via the Internet, to the full panoply of other data that the SEC requires funds to make public.

To its great credit, the Commission has seized upon this potential of the Internet in re-conceiving its approach to mutual fund disclosure. In the release I mentioned, the SEC advanced the idea of giving investors a Summary Prospectus – a short, concise, plain-English document consisting of key information about the fund, including investment objectives and strategies, risks, costs, and performance.

Those who still want the long statutory prospectus would be instructed on how to get it – and additional information about the fund. They could get this data on-line, or have a hard copy promptly sent to them for free. In concept, the Summary Prospectus is like the quick-start card that comes with new consumer electronic products. It tells you what you need to know to get started and to operate proficiently. If you want more detailed information, you can look at the owner's manual, which might be in print or on a CD or on the manufacturer's website. Or, in our case, in the statutory prospectus and SAI, which would both still be available and easily accessible.

Our own extensive research and the SEC's – not to mention the overwhelming majority of the public comments the SEC has received about the proposal – strongly suggest that this is the right approach.

Today we're releasing the results of a new survey that confirms that conclusion. The survey involved showing the proposed Summary Prospectus to about 500 recent mutual fund buyers and getting their reactions to the concept and the specific document.

In a nutshell, overall investor reaction to the proposal was highly positive. Most respondents thought the summary prospectus:

- was "about the right length";
- would make it "easier to compare funds";
- "contained enough information," provided more detailed information was still available to them; and
- was something they, as investors, were "more likely to use" than what they get today.

We also asked again about investors' Internet usage. Nearly all – 95 percent – of the survey's respondents said they were Internet users, and 73 percent said they went online every day. Internet use by older investors is also high: 85 percent of respondents aged 60 or older said they used the Web, and 55 percent said they used it every day.

Our survey findings are consistent with earlier research that contributed to the development of the Fund Profile. And they certainly add empirical support for the SEC's pending proposal.

Of course, none of this surprises those of you who prepare prospectuses for a living. With apologies to Winston Churchill, it seems to me that never has more been written for so many and read by so few!

So, are we finally on the threshold of a new approach to mutual fund disclosure?

I certainly hope so. This time around, the SEC has thoughtfully addressed the liability issue that helped sink the Fund Profile, and that's encouraging. But, as always with a rulemaking of this significance, there is a lot to consider, including the relative costs and benefits of various alternatives.

The SEC has decided — wisely, we think — to make the Summary Prospectus proposal voluntary. And there is no doubt that the vast majority of funds want something like the Summary Prospectus.

But funds will choose whether to opt for the new disclosure model, or to stay with the old, on the basis of a variety of very practical considerations. That means that, in designing the final regulation, the Commission has the power to encourage and facilitate adoption of the Summary Prospectus – or discourage and impede it.

The SEC conducted a cost-benefit study of the Summary Prospectus proposal. We separately surveyed our members – and got responses from 42 complexes, representing some 3,200 funds and about 60 percent of industry assets. The results served as the basis for the detailed analysis that we submitted to the SEC on February 28 with our comment letter.

Happily, those results line up well with the Commission's estimates in most areas.

There is, however, one aspect of the proposal that is highly problematic – a requirement that funds update performance and portfolio holdings data in the Summary Prospectus on a quarterly basis.

Our analysis found that 80 percent of funds would find the Summary Prospectus a manageable proposition – and would be more likely to adopt it – without this quarterly updating. But if quarterly updating is required, the share of funds likely to switch to the new system could drop to 30 percent.

Why is this quarterly updating requirement so significant? Today, as you know, prospectuses are updated just once a year. Still, the task is enormous – especially when you consider that the vast majority of fund assets are in families with an average of 80 funds apiece. Fund families stagger their fiscal years to spread the burden of revision for multiple funds across the calendar. Even so, as many of you can attest, the workload can seem crushing.

Quarterly updating, as the SEC plan proposes, would inflate that burden. Why? First, our members tell us, because they will feel compelled to review all of the contents of the Summary Prospectus as the legal offering document of the fund, not just revise the performance and holdings data.

Second, all these updates – for every fund that adopts the Summary Prospectus – would be required within one month of the end of each calendar quarter. Cancel all leave for January, April, July, and October! Even with the extra personnel and technology that funds would add, this highly regimented schedule would cause very significant management headaches.

Those are just the issues for fund families. Brokers and other intermediaries would face their own challenges, sweeping the shelves every quarter to ensure that they're not selling a fund with an out-of-date Summary Prospectus.

Some will say: Wait a minute – funds prepare new fact sheets every quarter. How is this different?

Remember, again, the liability issues that sank the Fund Profile. Any prospectus – including the new Summary Prospectus – carries a legal status that demands a higher standard of care in its preparation and review than does sales literature. The level of scrutiny necessary for any prospectus, Summary or traditional, is significantly greater – as are the business and legal implications of error or delay.

And what's to be gained by embedding this information in the Summary Prospectus? If we don't update the Summary Prospectus every quarter, will investors be disadvantaged? I would say no, simply because that information is readily available elsewhere, including online.

On all sides, there seems to be agreement that investors want and need the brevity and clarity that the Summary Prospectus offers. And it is the investor who will lose if the long quest for a better approach to fund disclosure fails yet again.

Absent a compelling reason to conclude that quarterly updating is an indispensable feature of the Summary Prospectus, the SEC should move forward without it. Let's get the Summary Prospectus into widespread use. Then, we can improve upon it if improvements are necessary.

Washington has a way of turning the best into the enemy of the good. Surely, we can – indeed, we must – resolve this in a way that is fundamentally good for the shareholders in our funds.

Let me add a personal note. I've been involved in this issue for 15 years. I strongly believe in the concept advanced by the SEC. Our shareholders have made it clear that this is what they want. I believe they have every right and reason to want it. Assuming a final rule addresses the practical issues successfully, I hope that firms around the industry will do everything possible to put the Summary Prospectus in the hands of our shareholders.

You can hear and talk more about this during the session on Prospects for the Summary Prospectus, which starts at 10:45 this morning in Grand Canyon 7-13. And the new ICI investor survey I referred to is available for printing at the Internet kiosks outside this room, in the forthcoming CD of conference materials, and of course on our website, www.ICI.org.

It is now my pleasure to introduce our keynote speaker.

Paul Atkins has been an SEC Commissioner since 2002, a tumultuous and eventful era for the SEC and for our financial markets. Throughout this time, he has served investors and the American people with great vigor and effectiveness. His has been a strong and independent voice. While sometimes controversial, the policies he has urged and positions he has taken invariably have reflected his powerful intellect, strong principles, extensive experience, and diligent consideration. One can hardly ask more of any public servant.

We are grateful that Paul has taken such a serious interest in regulatory policies affecting registered investment companies. Like ICI, he also has emphasized the need for the SEC to perform rigorous empirical analysis of proposed rules, including their likely costs as well as benefits.

Ladies and gentlemen, please join me in welcoming Commissioner Paul S. Atkins.
