IDC Independent Directors Council
Promoting Excellence in Fund Governance

2005 Compliance Programs Conference: SEC Rulemaking

2005 Mutual Funds Compliance Programs Conference

Welcome Address by

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Welcome to the Investment Company Institute's second annual conference on mutual fund compliance programs -- a conference I am confident you will find to be both timely and informative. In putting it together, the Institute's staff worked closely with the Chair of our Chief Compliance Officer Committee, Jim Davis of Franklin Templeton Investments, and the Chair of our Compliance Advisory Committee, Christine Carsman of AMG. The conference program features sessions devoted to fostering a strong fiduciary culture and ethical conduct within fund complexes, to ongoing implementation of the SEC's compliance rule, and to "hot" regulatory topics such as disclosure, trading practices, codes of ethics, electronic records, and enforcement issues. Discussion sessions will offer attendees an opportunity to explore particular aspects of the compliance rule with industry experts. I want to thank Jim and Chris for their leadership in planning this conference, and thank all of our speakers for their participation. Let me also recognize and thank those members of the ICI staff – particularly Tami Salmon, Jennifer Odom, and Christin McGrath – who have been instrumental in this conference.

You know, the beginning of this month marked the completion of my first year as President of the Institute. During that period, I have spent much time thinking about what lessons we can learn from the industry's recent experience.

In this regard, I was so struck by a Michael Shaw cartoon that I came across in a May 2004 edition of The New Yorker that the original now hangs in my office. The cartoon depicts a committee chairman addressing a witness in a hearing room and instructing him as follows: “Pay attention please, as the ethics have changed.”

The point of the cartoon, of course, is that ethics do not change – and that is a key lesson for all of us. We invite our shareholders’ trust, and we have a corresponding duty to be unswervingly loyal to their interests. Our fiduciary duty is something that never changes. Elementary as it is, this fiduciary principle of loyalty should serve as our “true North” – as the pole star by which we set our course and measure our progress. It is the only compass heading that points towards success in the mutual fund business. As you in your compliance roles work through the thicket of laws and regulations and procedures that govern our business, always take time to consult this basic principle. If you abide by it, you cannot go far wrong.

Well, if ethics do not change, the compliance and regulatory environment certainly does – and there is no rest for the weary. Indeed, the obligations imposed by the compliance rule impact – and will continue to impact – funds each and every day. While funds have cleared the initial hurdles of the rule, there is much yet to be done today, tomorrow, and into the future. In the near term, funds are focused on ensuring that they have adequate controls in place and they are testing their programs to assess their effectiveness. They are fine tuning their processes to detect and report material compliance matters. And, chief compliance officers across the industry are determining how to prepare and present their first annual report to fund boards.

When I became President of the Institute last year, I pledged that ICI would assist funds and their CCOs in this implementation process. Over the past year, we have created a new standing committee comprised exclusively of fund and adviser CCOs. This committee provides a unique forum for CCOs to bring compliance challenges into sharper focus by discussing issues and techniques with their peers throughout the industry. This committee is so popular that, at its first meeting last fall, we had close to 200 attendees.

Our members have asked for information about how different fund complexes are implementing the compliance rule. For this purpose, we have developed and fielded an industry-wide survey that explores, for example, how funds have structured their CCO positions, how they are monitoring the ongoing implementation of their policies and procedures and those of their third party service providers, how they are testing their operations, how they are identifying material compliance matters, and how fund CCOs are interacting with their funds’ boards. We recently sent this survey out to approximately 135 firms and we expect to report on the results to participants later this year.

Members also told us that they would benefit from additional information on methods they might use to test their compliance programs. As you know, while the SEC’s release adopting the compliance rules discusses the need for funds and advisers to test the effectiveness of their compliance programs, it does not specify how they should do so. The Institute is currently working on a white paper that will

address this important topic.

Helping funds and advisers fulfill their compliance obligations is an important part of the Institute's mission of promoting high industry standards. And these compliance obligations grow ever more numerous and complex.

As you know, under the SEC's ambitious mutual fund reform agenda, 10 of the 12 reform proposals issued by the Commission since September 2003 have already been adopted. These 12 reform proposals followed on the heels of a host of other new laws and regulations that significantly impacted mutual funds. These include, for example, the Gramm-Leach-Bliley Act, with its detailed privacy standards; the Sarbanes-Oxley Act, with its certification requirements, disclosure controls and procedures, and code of ethics and financial expert provisions; and the USA PATRIOT Act, with its complex anti-money laundering requirements.

These, and other recent laws and regulations, have necessitated fundamental changes to both business operating systems and business cultures. They also have imposed substantial new costs on funds and fund advisers -- at a time when there are constant calls for funds to lower their fees. I believe that funds now need – and deserve – some "breathing room" to enable them to absorb and implement the surge of new regulations.

The Institute supports strong and effective regulation to protect the interests of fund shareholders. We always have. At the same time, we believe it is incumbent upon regulators to consider carefully the implication of the burgeoning number of regulations that uniquely impact mutual funds. Just last month, in testifying before Congress, I underscored the importance of avoiding overly burdensome regulation that could have the effect of making mutual funds less competitive, less innovative, less attractive to talented investment firms and professionals, and less available to investors.

My testimony also emphasized the need for the SEC to conduct more informed and rigorous analysis of the costs as well as the expected benefits of new regulation. Such analysis is critically important to any effective regulatory process. The Institute intends to become a more active commentator on this aspect of SEC rulemaking and to conduct our own cost-benefit research to contribute to the body of learning before the SEC. We will be looking for your help as we undertake to assess the initial and the ongoing costs of proposed and existing SEC regulations.

In my testimony, I also applauded outgoing Commission Chairman William Donaldson for recognizing the need for internal reforms at the SEC that will enhance the effectiveness of its regulatory and law enforcement efforts. We hope that his successor as Chairman, and indeed all members of the Commission, will sustain the effort he began. In this regard, we have urged attention to three issues in particular:

- First, the need for better coordination among the different SEC divisions and offices that deal with mutual fund issues – particularly the Division of Investment Management and the Division of Market

Regulation;
- Second, better coordination of, and other improvements to, the inspection process, including a reconsideration of OCIE's extensive use of "sweep" exams and steps to ensure that de facto rulemaking is not occurring through the inspection process; and
- Third, long overdue improvements in the handling of exemptive applications to eliminate the lengthy and unnecessary delays that characterize the current process.

Attention to each of these areas would be of tangible benefit to mutual funds and their investors.

At the end of the day, it must be our shared objective to achieve a regulatory regime that protects investors and preserves mutual funds as a vibrant and effective tool for average investors to reach long-term financial goals. Provided we never lose sight of our "true North," and we work collaboratively and constructively with policy makers, and regulators, I am certain we will meet that objective.

Thank you for your part in this important endeavor and for your support of the ICI. Enjoy the conference!
