Keynote Address, 2020 ICI Tax and Accounting Conference (Virtual)

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Delivering on the Promises We Have Made to Investors

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As prepared for delivery.

Thank you, Keith [Lawson], both for that introduction and for the hard work that you and your ICI colleagues—Karen Gibian, Katie Sunderland, and Greg Smith—have put into organizing this conference.

And sincerest thanks to all of you who are in attendance today at this, the first-ever virtual ICI Tax and Accounting Conference. In fact, this is the first virtual conference in the Institute's 80-year history. You all are part of a great new venture for us. We hope to bring you the same rich content, the same depth of expertise, the same insights and knowledge that we would offer if we were all together as in past years. In short, all of the substance—but none of the calories—of a traditional conference!

I hope you will benefit enormously from the time and attention that you devote to the conference today and over the next two Tuesdays. And we look forward to your feedback and your suggestions on how to make these events even better.

I'm speaking to you today from the David Silver Conference Room at ICI's headquarters—the Institute's Board room. Very few of us on the ICI staff have been in our offices, two blocks from the White House in Washington, DC, since March 12. This is my first time back. It's a bit of a shock to be here and to reflect on the events of 2020. Events that would be unbelievable if we had not lived them ourselves.

For me, this time has a special poignancy. As you may know, I announced in January that I would retire at the end of 2020, after 16½ years as president and CEO of the Institute. Six weeks later, we closed our offices, and I expect to spend my final days with ICI working from home, seeing colleagues only online, and speaking virtually to conferences like this.

This is certainly not the way I envisioned ending my 42 years of working life. But it has caused me to reflect on different chapters of my time as head of ICI and on lessons to be drawn from those experiences. I thought I would share some of these parting thoughts with you today. I will survey five conspicuous challenges that arose on my watch, what they demanded of us and how we responded.

You know, it is commonplace in literature that an author will begin a narrative *in medias res*—that is, in the midst of things. So, let me start with the crisis that we are in the midst of now, the COVID-19 pandemic that broke upon us with such force early in the year, with the end still not in sight.

Firms started cutting off travel in February—first international travel, then domestic. Then in a single weekend in the middle of March, the vast majority of our US member firms closed their offices and went to 90 percent or greater remote work. Thousands of other American businesses were also switching to remote work or shutting down on government orders, sending an enormous shock through the economy. Financial markets saw this coming, and businesses and institutions engaged in a dash for cash, a race to make sure they were as liquid as possible for the unknown circumstances ahead.

To its enormous credit, the US government responded vigorously to this crisis. Congress approved three separate relief packages, with the third—the $2 trillion CARES Act—representing the largest grant of fiscal relief in US history. The Federal Reserve acted quickly, creating at least nine emergency facilities, adjusting them as needed, and pumping out trillions to provide liquidity and reassure markets. The Securities and Exchange Commission provided vital regulatory space for funds and their boards to adapt to the new world of virtual operations. But in the early days of the crisis, over a few tense weeks, we wrestled with both extraordinary market turmoil and vast operational challenges. And we were all put to the test.

As tax and accounting professionals, you are one of many communities that come together to make fund investing possible. Others include industry operations professionals and service providers; information technology and information security teams; risk managers, compliance officers; and business leaders. Their ranks have focused intently on business continuity over many years in order to maintain, even in the most adverse circumstances, the smooth functioning of a vast infrastructure on which funds and their shareholders depend.

For decades, ICI has worked closely with all these communities in the industry. And true communities they are, dedicated to reducing risk for the neighborhood at large and working together through ICI to that end.

The truly good news is how much all these efforts have paid off during the pandemic. The public health crisis imposed drastic changes on well-established patterns of work that no one could have contemplated. We may never quite return to the traditional workplace model, but we have continued to deliver on our promises to our shareholders.

Planning and resilience and community truly matter. They always will.

But these are not conditions that can be created after the storm strikes. They are a product of years of effort and collaboration. More important, they are the product of a culture that says the mission—and our shareholders—always come first.

Delivering on the promises that we have made to investors—in the face of a once-in-a-century health crisis. Even if we face further setbacks, this will go down in our history as one of the industry's finest hours. And you were all part of it! I congratulate each of you for the role you played—for your part in the resiliency that is such a vital quality of our business.

In the months since March and April, market conditions have improved and we all have grown accustomed, like it or not, to our days spent in virtual meetings. But we are likely to be dealing for some time with fallout from that market turmoil. Regulators focused on financial stability have signaled a renewed resolve to address perceived problems in non-bank financial institutions, beginning with regulated funds.

As major investors in global markets, regulated funds and their shareholders have a compelling interest in maintaining the stability of the financial system. But what we experienced beginning in March was quite different from the great financial crisis of a decade ago. The COVID-19 market shock in March was driven by a global health crisis and governments' response.

When Italy locked down its economy; when the US slammed the brakes on travel; when states and cities across America imposed stay-at-home orders—these were all steps taken to try to contain the spread of a deadly infectious disease. The resulting wave of market turmoil was inevitable, and funds were caught up in the riptide.

Policymakers must have a clear and accurate picture of what happened during the crisis, including the experience of funds and their investors. To this end, ICI is conducting a comprehensive examination of developments in fixed income and money markets in March and early April. We hope to release that examination later this fall. It will, among many other things, demonstrate that the US Treasury market—the deepest and most liquid market in the world—was the very first to seize up, and showed enormous strain several days before money market or bond funds came under redemption pressure.

The data also show that bond fund redemptions were a small share of those funds' assets—about 5 percent—and did not drive or exacerbate market volatility.

The COVID-19 crisis is fundamentally different from the great financial crisis of 2007–2009. The events of March 2020 were driven by a global public health emergency that has devastated economies and spilled over into financial markets. Those of a decade earlier, by contrast, originated in the financial system and had significant economic ramifications. But in both cases, ICI's response illustrates another critical quality of our industry: we take the initiative to address problems and support constructive solutions that will benefit fund shareholders.

In 2008, after more than a dozen major banks had failed, the Reserve Primary Fund became the second money market fund in history to "break the buck." In response, ICI's Executive Committee called for the Institute to investigate, to face up to any structural or regulatory factors that might have made money market funds vulnerable, and to offer constructive policy recommendations to regulators, even at some cost to fund sponsors and their products.

The result was the Money Market Working Group, a group of top executives and staff from ICI member firms. Chaired by Vanguard's Jack Brennan, that group produced a significant report in March 2009. In that report, the Institute suggested substantial reforms to SEC Rule 2a-7 designed to make money market funds stronger and more resilient for investors—new liquidity requirements, new limits on the maturity of securities these funds hold, stronger credit analysis and know-your-customer standards, and more options for fund boards to deal with heavy redemptions.

Less than a year after the Money Market Working Group Report came out, the SEC had adopted package of money market reforms rooted in the Report's recommendations—the first major regulatory reforms after the global financial crisis. These changes to Rule 2a-7 were completed six months before Congress enacted its response to the crisis, the Dodd-Frank Act.

This has been ICI's way over the years. For example, as ICI general counsel in the mid-1990s, I helped lead an effort to develop new standards of conduct for personal investing by fund personnel. And it was ICI that recommended to the SEC what eventually became the chief compliance officer rule.

Ours is an industry that is not afraid to confront problems. And ICI has always been a trade association committed to working with regulators to help them craft rules that are sensible, cost-effective, and oriented toward the interests of our shareholders and of the markets that we serve. Taking the initiative and promoting industry consensus is one of the great strengths of the Institute—and something we have done on so many different subjects, over so many years. Addressing problems together and working toward constructive solution—may this always be characteristic of our membership and of ICI.

The Money Market Working Group report, and the SEC reforms that followed, greatly advanced the debate over post-crisis reforms but did not end it. In view of the damage caused by the crisis, policymakers focused on how to avoid a recurrence, emphasizing the need to address risks that could threaten the stability of the broader financial system. Initial reforms focused on the source of the global financial crisis: the banking system. But they did not stop there. Policymakers also focused on non-bank institutions, including asset managers and regulated funds.

The bodies that have led this effort since 2009, dominated by central bankers, understandably take a banking-centered view of the world. They called mutual funds and other capital-market participants "shadow banks," a characterization that was intentionally pejorative and wholly inaccurate. Well, as I have said so many times, regulated funds aren't banks, and they aren't in the shadows. Indeed, ICI has spent the last decade engaged in a policy debate that illustrates another of our industry's qualities: We stand on principle—even when that's difficult, unpopular, or risky.

For many reasons, the Institute recognized early on that "stability regulation" based on banking rules could—and probably would—compromise the ability of regulated funds to continue to serve their uniquely valuable role in our financial markets. Funds are the most efficient and effective aggregators and allocators of capital to the economy, a role we have developed over our 80-year history, and one that ICI has sought to foster over all that time. The damage done by these regulations would not be offset by any measurable benefits—because funds do not threaten financial stability, and so applying bank-like regulation to funds would not make the financial system any more secure.

The issue was and is one of great consequence. So, to make our case, ICI has filed dozens of comment letters, reports, and white papers with domestic and international regulators. We have produced data by the bushel and analysis by the pound to demonstrate that funds and their investors do not destabilize markets. We have examined, for example, more than 40 episodes of market turmoil, in the United States, Canada, and Europe, since World War II—and demonstrated that fund investors did not "run" or redeem en masse in any of those cases.

The struggle is not over, and we must continue to make our case. Our command of data—rooted in some of ICI's earliest activities, back in the 1940s—has given us a substantial advantage in these debates. But what has mattered most is our principled position and our willingness to fight for what ultimately is in the best interest of our shareholders and the capital markets. As Thomas Jefferson said, in matters of principle, one must stand like a rock.

Financial stability is, of course, an issue with global dimensions. We have engaged with the Financial Stability Board, the International Monetary Fund, the Bank of England, the European Central Bank, the European Stability Risk Board, and many more—a panoply of international bodies. We have traveled to London, Paris, Frankfurt, Basel, Zurich, Helsinki, Madrid, Tokyo—even Malta—to make our case.

This globe-trotting had come to seem second nature, at least until COVID-19 struck. But it was not always the case. It was less than a decade ago, in October 2011, that ICI's Board challenged us to step into a new global role on behalf of our members and shareholders. They saw that fund investing was increasingly a global phenomenon, asset managers were expanding into new markets, and regulatory interest in funds was increasing. And they wanted ICI to respond accordingly. So, in late

2011, ICI stood up ICI Global, the arm of ICI through which we conduct our international work.

We started with an office in London; shortly after we established an Asia-Pacific presence in Hong Kong. We now have dedicated staff in both locations, as well as in Washington, working on issues that transcend borders. And we now have members located on six continents. But as many of your firms have discovered, you cannot simply bolt on a couple of offices outside of the United States and become a global organization.

No—being truly global requires deep cultural change in every aspect of your operations. A “global mindset”—that is, an established set of attitudes that takes account of the international dimension of our mission—has become a key element of working at ICI and of participating in member activities, and one that we push very hard at every opportunity. We have taken an organization that for 70 years was largely focused on the US and transformed it in less than a decade into one with a global reach.

The pandemic has cast something of a pall over globalization. Fear of spreading the infection has curtailed air travel and closed international borders. This has exacerbated pre-existing trade disputes, aggressive industrial policies, and rising international tensions that threaten to fracture the global system. Political leaders seeking advantage for their “national champions” are adding new roadblocks to the sharing of technology and expertise.

Of particular interest to this audience, in Europe we see authorities trying to impose their tax and regulatory schemes on the rest of the world. They are trying to make EU taxes and regulations the price of entry to their markets. These unilateral measures threaten to impose a heavy burden on global fund operators. Nonetheless, taking a long view, I believe the forces that propel globalization will not be so easily stopped. Continued integration of economies around the world is inevitable. Over time, the flow of goods, services, information and capital will overtake any barriers that nations erect.

As ICI’s chairman, George Gatch, declared at last year’s General Membership Meeting: “The urge to reach out and explore; to bring home the exotic products of other lands; to create networks of production and trading and investment—that urge is as old as human history.” And for our industry, the urge to offer best-in-the-world services—wherever those may be housed, to all the world’s investors, wherever they may live—will continue to drive global enterprise.

So, I promised you five great qualities of our industry, and I’ve listed four:

- Being resilient;
- Addressing problems together and working toward constructive solutions;
- Standing on principle; and
- Maintaining a global mindset.

What’s the fifth? I saved it for last because it is the most important. But it also takes us the farthest back in time, to the very beginning of my tenure as president and CEO at ICI.

At that time, in June 2004, our industry was recovering from the worst scandal of its modern history. Certain fund sponsors had allowed hedge funds and other sophisticated investors to trade rapidly in and out of mutual funds to exploit temporary pricing lags—in violation of the funds' prospectus limits. Other fund sponsors were letting certain investors buy mutual fund shares after the 4:00 p.m. market close at that day's pre-closing price. These practices were a breach of trust toward other investors in those funds and caused a huge blow to public confidence in the fund industry.

When these abuses were revealed, ICI responded strongly. We supported tough action by the SEC, and we rallied the industry behind a series of regulatory initiatives designed to ensure that the late trading and market timing scandal could never recur. Why? Because the fifth quality of our industry—the one upon which all else depends—is integrity.

This is one of the last speeches I will give as head of the ICI. I have delivered many over the years, but my mind often turns back to my very first public remarks as ICI's president and CEO, in 2004 at the National Press Club. As I said at that time, our industry is founded on trust.

Investors have many reasons to favor funds over other forms of investing. But they are unlikely to commit their savings to a fund unless they feel it is a fund they can trust. Investors are unlikely to risk their security in retirement, or the education of their children, unless they trust that their fund is managed prudently and committed to their interests. They understand that markets go up and down, and they accept these inherent risks in investing. But the risk of abuse or dishonest conduct is a different matter altogether.

The late trading and market timing scandal showed that a few bad actors could put that trust at risk for our entire industry. That is why ICI forcefully supported SEC action to punish the wrongdoers and strengthen regulations.

That episode was an aberration—a rare breach of trust. I dare say that, in the long history of finance, no industry has served more clients longer with fewer lapses than have mutual funds. That is no reason for complacency. Indeed, the question must always be before us: how do we ensure the integrity that our investors and our business rely upon? The answer, as I have said repeatedly throughout my 16 years at the helm of the Institute, is that we must dedicate ourselves to our role as fiduciaries.

What is a fiduciary? What is it about the nature of a fiduciary relationship that makes it so distinctive? As I explained in 2004, the concepts underlying the term "fiduciary" spring from customs and beliefs of the ancient Romans. The pagan goddess Fides was the personification of good faith. Her symbol was the outstretched hand, given as in solemn agreement.

"Fiducia"—a term in Roman law meaning confidence, trust, reliance, assurance—is closely related to the Latin noun "fides," signifying belief or faith. The adjective form, taken by the US Marine Corps as part of its motto, is "fidelis"—meaning a person or institution that can be trusted or relied upon, who is true, steadfast and faithful. Essentially, a fiduciary is one who takes it upon himself to act for or advise another, thus inviting the other's confidence and trust. Under our law, the distinguishing obligation of a fiduciary is the obligation of loyalty.

Fulfilling such an obligation is no small matter. Especially in a social enterprise as large and important as mutual funds, trust—that is, the expectation that one will do what one is relied on to do—is precious and necessary indeed.

As the character Thomas More says in the 1966 film *A Man for All Seasons*, when a person assumes such a responsibility, "he's holding his own self in his own hands. Like water. And if he opens his fingers then—he needn't hope to find himself again."

And this is an obligation that must be undertaken willingly, with eyes wide open. As Supreme Court Justice Felix Frankfurter once said, "he who is unwilling to assume the responsibility of a fiduciary has no business being a fiduciary."

Our funds thrive today because over the past 80 years, thousands of capable and dedicated men and women have willingly borne that mantle.

You are here today, as part of this great enterprise, because in your own roles you have taken upon yourselves a responsibility to help earn and keep the trust and confidence of fund investors. To do what you are relied upon to do, to place the interests of your shareholders and clients first, ahead of everything else. That is a precious burden indeed.

It has been a great joy to work alongside those of you who share in this mission. It has been a great honor, for most of the four decades of my working life, to be a part of this enterprise. It has been a great pleasure to be here with you today, and to be allowed to share my thoughts with you as you start this conference. Thank you, and godspeed.
