

Regulatory Address, 59th General Membership Meeting

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Thank you, Jim [McNamara, GMM chairman, and president and CEO, Goldman Sachs Mutual Funds]. And thanks again for your part in putting together this year's program. From every session, our audience has gained new insights and ideas that they can put to use. It has been an outstanding conference.

This year, insight seems to be more important than ever as we struggle to discern the significance of all the changes we seem to be witnessing in politics, economics, and global security. Later this morning, Ian Bremmer of the Eurasia Group will help us all better understand this time of global turmoil and uncertainty.

My mission this morning is more modest, but I hope of no less interest—to give you some insight into the regulatory outlook for funds here in the United States.

At the Securities and Exchange Commission [SEC], the new chairman, Jay Clayton, was just confirmed on Tuesday—almost four months after his appointment was announced. Two other seats remain

unfilled.

At the Department of Labor, Secretary Alexander Acosta has been on the job for one week, with a mandate to address quickly the fiduciary rule.

So I can't guarantee you clarity and certainty on the regulatory outlook—not in granular detail.

But when I step back and look at the bigger picture—look at the direction of travel in the current administration—I believe that we can offer an outlook for regulation that will improve prospects for our investors and our nation.

Striking a Balance on Regulation

For more than 75 years, ICI and its fund members have been strong advocates for efficient, effective regulation. The funds we represent embrace regulation as a necessary component to establish and build trust among investors. Without that trust, investors would not allow us to manage more than \$19 trillion in US funds, nor trillions more in regulated funds in other jurisdictions. Undoubtedly, sound regulation is a fundamental condition of our success.

But regulation that is unnecessary or inappropriate, that is based in faulty analysis, that is not informed by robust public comment—regulation of that sort can and does hurt fund investors and impose huge costs on our economy and our society.

President-Elect Trump identified the crucial balance when he announced that, as SEC chairman, Jay Clayton “will ensure our financial institutions can thrive and create jobs while playing by the rules.” Mr. Trump called upon the SEC “to undo many regulations which have stifled investment in American businesses, and restore oversight of the financial industry in a way that does not harm American workers.”

Meeting the Challenge of Growth

President Trump's goal is to unleash economic growth—because the most pressing need today is for greater growth. In the United States, the economy has gained about 2 percent per year since the financial crisis—well below the post-World War II trend exceeding 3 percent. And even at that rate, America has enjoyed a stronger and steadier recovery than Europe and many other parts of the world.

Stronger growth is a crucial part of the solution to so many challenges for our society. And reducing excessive regulation is a crucial part of the solution to sluggish growth.

In a landmark study released last year, Michael Porter and colleagues at the Harvard Business School asked both Harvard alumni and the public what factors were helping or hurting US competitiveness. Both groups identified “regulation” as an element where the United States was weak relative to other nations—and deteriorating.

The US Chamber of Commerce last summer found that more than three out of four companies surveyed “believe that the regulations on the financial services sector will not help their companies’ outlook over the next three years.”

Just last month, an international advisory group called [Business at OECD](#) urged the Group of 20 leaders to address “the twin structural challenges of low productivity growth and rising inequality” by improving the financial environment for small and medium enterprises. The group’s analysis concludes that these entrepreneurial businesses “remain constrained in their ability to access appropriate financing, which is holding back their participation” in growth and job creation.

Here in the United States, companies are increasingly passing up the opportunity to gain financing in the public markets. A new analysis by Credit Suisse finds that listings in US public equity markets have fallen by half in the two decades since 1996. The [Wilshire 5000 Total Market Index](#) now covers only 3,599 stocks—in fact, it hasn’t included 5,000 stocks since December 2005!

Why? The Credit Suisse analysts find that regulations have driven up the cost of listings—especially since the passage of the Sarbanes-Oxley Act in 2002. And the benefits of listing have fallen, as alternative vehicles—venture, buyout, and hedge funds—make it easier for companies to raise funds in the private markets.

But this trend means ordinary investors—typical mutual fund or ETF [exchange-traded fund] shareholders—have less access to opportunities that the economy offers. Indeed, given that newer firms are less likely to trade publicly, individual investors find it harder and harder to share in some of the most dynamic sectors. This cannot be good for US capitalism, premised on sharing the fruits of innovation far and wide.

Setting a New Course

What can be done?

At his confirmation hearings, Jay Clayton observed, “Well-functioning capital markets are important to every American; all Americans should have the opportunity to participate in, and benefit from, our capital markets on a fair basis.”

We strongly agree. Indeed, the funds ICI represents are an essential vehicle for this purpose. They have a vital role to play as Chairman Clayton pursues the goals of economic growth and investor opportunity.

And we have some ideas about how the SEC can help them play that role to greatest effect. These include:

- preserving the fundamental framework of fund regulation;
- ensuring that all investors—whether in retirement plans or retail accounts—have access to financial advice under a best interest standard;

- permitting funds to continue to use the most advanced investment tools and techniques; and
- bringing our means of communications with fund shareholders into the 21st century.

This is an agenda that will serve our economy—and our investors.

A Harmonized Best Interest Standard

Let me start with the issue that is most on our members' minds—the Labor Department's disruptive and harmful fiduciary rule. And let's deal with the tough message: Yes, the rule takes effect on June 9—and prospects for further delay are uncertain.

ICI and its members devote enormous energy to meeting regulatory deadlines like this. They will be as ready as humanly possible on June 9.

That said—we are deeply disappointed that the rule's implementation was delayed by only 60 days—because the rule is already causing great harm.

Our members report that hundreds of thousands of small retirement accounts have been “orphaned” since the Department of Labor (DOL) finalized the rule. Faced with the sizable if uncertain legal and regulatory risks of assuming DOL fiduciary status vis-à-vis these fund shareholders, brokers are simply resigning from small accounts en masse.

Shareholders will lose the relationship they've depended upon, with none to take its place. Certainly, with the movement to omnibus accounts, many funds no longer maintain the infrastructure required to administer these accounts directly, much less to do so in a manner consistent with the DOL rule.

ICI predicted that the DOL rule would have exactly this consequence. DOL brushed that concern aside, with seeming indifference to the implications for the hundreds of thousands of small savers and investors affected.

All this carnage is unnecessary, because in the end, we believe the rule must be rescinded or significantly revised.

After all, the DOL's rule runs afoul of every one of the criteria that President Trump set forward for its review. It will force many investors to pay more for advice—or to go without advice altogether. It is already disrupting the retirement services industry. And it will create more, and more costly, litigation.

President Trump has pledged “to facilitate [Americans'] ability to save for retirement.” The DOL rule would move in exactly the opposite direction—and thus it must be replaced with something that works to help America's retirement savers.

ICI and its members strongly support a requirement that all financial advisers act in the best interests of their clients—whether in retirement or retail accounts. We are calling upon the SEC to propose a harmonized best interest standard for broker-dealers that would enhance, rather than replace, existing

suitability obligations.

Only two bodies can lead the way on a unified best interest standard—the SEC and Congress. We hope the SEC will take the lead—but if it doesn't, Congress should stand ready.

A Modern Regime for Funds' Use of Derivatives

A solid best interest standard will ensure that fund investors have access to financial advice. But we also must protect their access to the best and most efficient portfolio management we can offer.

From their beginning, funds have brought the best of investment management to the investor of moderate means. They made it possible for average shareholders to secure the services of the best talent and the benefit of the best investment techniques. We must fight to preserve that legacy.

In today's world, that means we must maintain funds' ability to use derivatives—to hedge risk; to enhance liquidity; to gain exposure to hard-to-reach asset classes; to reduce costs. Derivatives are indispensable tools to bring the benefits of the markets to ordinary Americans.

The Commission has proposed a rule to modernize decades' worth of guidance on funds' use of derivatives. ICI supports that rule in part: we agree that funds should establish formal derivative risk management programs, and we support appropriately tailored asset segregation requirements.

But other portions of the proposed rule would sharply—and excessively—restrict funds' use of derivatives. Proposed portfolio limits, for example, could stop funds from using instruments that reduce risk and improve liquidity—even for plain-vanilla bond funds. Hampering funds or driving them to de-register will cost investors more—or deprive them of core strategies.

Today, we are calling upon the SEC to issue a new proposal—a rule that combines formal risk management programs with an appropriate asset segregation regime. Such a rule will encourage funds to invest in the derivatives market confidently and responsibly—to the ultimate benefit of their investors.

Preserving the Framework of Fund Regulation

As you'll recall, the SEC's 2015 derivatives rule proposal grew out of Chair White's multipart agenda for asset management—which itself was designed to ensure that the SEC would maintain control over fund regulation.

At that time, the bank regulators that dominate the US Financial Stability Oversight Council (FSOC) were dead set on subjecting the largest US funds and their advisers to a wholly inappropriate and unnecessary regime of capital, enhanced prudential supervision, and other bank-type regulations.

Ever since the Dodd-Frank Act was in draft, we have rejected any need or justification for FSOC to designate regulated funds or their managers as SIFIs—systemically important financial institutions.

The history of regulated stock and bond funds in America clearly demonstrates that these funds have never caused the sort of risks that threaten the financial system or the broader economy. And the structure, regulation, and operation of these funds make such risks remote.

But that hasn't stopped the Office of Financial Research, or the FSOC—or its global counterpart, the Financial Stability Board—from conjuring up risks about what they continue to disparage as “shadow banks” and promoting policies based upon the specters they invoke. Only by an overwhelming weight of evidence and analysis have we slowed their march.

An independent study by the American Action Forum estimated that inappropriate capital standards could cost a 25-year-old retirement saver up to 25 percent of returns—as much as \$107,000—over a lifetime. And that's just one aspect of SIFI regulation.

Now, happily, both the administration and the leadership in Congress appear intent on addressing the issue. Just two weeks ago, President Trump directed the Treasury secretary to block any designations of nonbank financial institutions, pending a thorough review of the Council's designation process. We applaud the president's action.

Meanwhile, on Capitol Hill, the House Financial Services Committee has adopted Chairman Jeb Hensarling's revised version of the Financial CHOICE Act to address many of Dodd-Frank's excesses. That bill would revoke the FSOC's authority to designate nonbank SIFIs—including funds and their managers.

We support this objective. In the last Congress, legislation to address flaws in SIFI designation drew bipartisan support—including 31 Democratic sponsors. So we are hopeful that this Congress can address the dangers that SIFI designation poses for our industry.

Bringing Fund Disclosure into the 21st Century

The last issue I want to discuss today should resonate clearly with the vast majority of investors—the 92 percent of US mutual fund-owning households who have access to the Internet.

In nearly every other corner of our economy and financial system, consumers readily receive and seek out information online. Yet fund investors are burdened with an antiquated system of paper-based delivery for voluminous shareholder reports and other documents.

Unless investors affirmatively opt for electronic delivery, their mailboxes are stuffed with materials that very often head straight to the recycle bin.

Printing and mailing all these reports is costly: ICI estimates that a move to full electronic access could save close to \$4 billion over the next 10 years—savings for funds and their shareholders, not for fund sponsors.

Printing and mailing also exacts steep environmental costs. Almost two million trees are cut down every year just for US funds' shareholder reports.

Importantly, paper-based disclosure limits investors' ability to make the best use of the information they receive. I suspect that even the most diligent investor balks at plowing through hundreds of pages of fine print. Generations raised on hyperlinks and Google searches can only wonder why funds have not moved wholesale to online delivery. Taking down the regulatory barriers could unleash innovations enabling shareholders to find what they need to know, when they need to know it, with layered disclosure, easy navigation, and links to other relevant resources.

Meanwhile, the SEC should also preserve the option for fund investors who want paper to continue to receive paper. All they would have to do is register their preference—once.

The SEC came close to improving online delivery in the waning days of 2016. Now, we urge the new Commission to adopt a three-stage process for bringing fund disclosure into the 21st century:

- The SEC should immediately adopt a rule that allows mutual funds, ETFs, and closed-end funds to meet their delivery obligations by posting required disclosure documents online and providing investors the opportunity to opt for paper.
- At the same time, the SEC should permit variable insurance products to develop and use summary prospectuses, delivered online.
- As a longer-term initiative, the Commission should review the content of fund shareholder reports to make them more useful to investors.

Restoring Balance to Our Financial System

If you read or watch the news, you might have noticed that President Trump recently marked his 100th day in office. You also might have picked up the media's surprise that he hasn't delivered on all of his campaign themes already.

Well, Washington doesn't work that way—at least not in the areas that concern us. It took a decade or more for the layers of financial regulation to build up, and we're not disappointed that they haven't been peeled away in 106 days.

Instead, we are pleased by what we've seen on financial regulation: the executive orders; the presidential memoranda; the declarations by nominees; and the tide on Capitol Hill. Most of all, we are pleased by the emphasis on regulation that serves investors and the economy—rather than regulation for its own sake.

We are prepared to work as long as is necessary to restore balance to our financial system, so that our country can unleash its entrepreneurial and innovative powers. ICI and its members look forward to that challenge.

Thank you.

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