

ICI Chairman Stresses Fiduciary Culture of Fund Industry

Chairman's Keynote Address ICI Education Foundation Securities Law Developments Conference

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Thank you, Karrie, for those kind words, and good afternoon to you all. It's a distinct honor to be asked to serve as your keynote speaker, because every year the Securities Law Developments Conference is one of the premier meetings on the ICI calendar. For 22 years, the ICI Education Foundation has been helping keep the legal community, both our fund company members and outside counsel, up to date on all the vital developments surrounding investment companies. It's heartening to see you all here today, taking advantage of this opportunity.

Let me say at the outset that I am not a lawyer. Normally, that would be the set-up for a lawyer joke—and there are is no shortage of great jokes! When you work with as many lawyers as I do, you hear them all. But no jokes today, because I have tremendous respect for what you do. Instead, I'd like to talk today about what I see as the role of lawyers in the fund industry—and how that role is playing out in the many issues we've faced, and will continue to face, in the financial crisis.

Our industry serves almost 90 million investors across America, and the products and services we provide those investors come with the strongest regulatory framework of any investment product. We embrace that regulation—even though it means we need a lot of lawyers.

When I think about the role that our attorneys play, I come up with two principal messages:

My first message is that, as the legal advisers to our funds, you are keepers of the flame for the fiduciary culture of investment companies. You play a critical role in protecting, nourishing, and advancing the principles that funds live by—first and foremost, our central focus on serving and protecting the interests of shareholders.

But how do you exercise that role? My second message is that I would encourage you to see yourselves as counselors—not just cops. Yes, it's critical that you bring all of your technical legal expertise to bear to ensure that your firms, or your clients, are meeting both the letter and the spirit of the law. But if you look around the industry at the great general counsels and the most influential legal advisers, you'll find that these are men and women who understand the business of investment management as well as they understand the '40 Acts, the '33 Act, the '70 Amendments, or any of the dozens of regulations you're here to discuss today. The best legal advice comes from those who understand the business reasoning as well as the legal necessities of the decisions your companies make.

To put that in context, let me discuss what we've just been through—and what we're facing.

We have just weathered the worst financial crisis since the Great Depression. I won't say that it's over yet. But I will say—cautiously—that the worst does seem to be behind us.

For investors, this crisis caused widespread losses and financial damage. Many have had to change their objectives for retirement and other financial goals. They've reassessed their attitudes toward risk and their approaches to investing. Helping them through this adjustment is a major challenge for funds and advisers.

For mutual funds, this crisis was a very real, and real-time, stress test. Some of our core products were put at risk. We had to rally together, as an industry, to address these threats and find ways to continue to serve our shareholders, under enormous strains and pressures.

ICI, I'm proud to say, was central to those efforts. During the bleakest days of the crisis, as I was driving home after a long day in the office, I would think, "I bet the lights are still burning at the ICI." And when I'd check my email, I'd see that the team from ICI was indeed hard at work, late into the night.

I'm sure that the same was true in your offices. As our legal advisers, you were on the front lines of these efforts. Your advice, your cooperation, your collegiality were crucial to helping our companies weather that storm.

On behalf of the entire industry, and our shareholders, I thank you.

That was an experience none of us will ever forget. It shaped us. It was a formative experience that will influence the judgments you make for the rest of your careers. But as you've heard this morning, the crisis has also reshaped thinking about the entire regulatory system for financial services. More changes are coming our way ... more challenges ... more midnight oil.

As we face those challenges, however, one thing cannot change: The fiduciary culture of our industry.

The latest crisis is often compared to the Great Crash of 1929 and the Great Depression. So let's take a look at some history.

The first investment companies in America were not known for their concern for investors. In the runaway bull market of the 1920s, investment trusts were virtually unregulated, and their managers exploited this freedom. In just three years, from 1926 to 1929, the assets of these companies grew from less than \$1 billion to more than \$8 billion. Economist John Kenneth Galbraith said that investment trusts were [QUOTE] "the most notable piece of speculative architecture of the late twenties." But the most damning assessment came from one of our own—an investment company manager named Paul Cabot, who warned early in 1929 about [QUOTE] "dishonesty, inattention and inability, and greed," and predicted that investment companies were headed for a time of [QUOTE] "disaster and disgrace" that was "inevitable."

That disaster did arrive, with the Great Crash of 1929. But after that calamity, the most far-sighted members of our industry created a new culture for funds. They worked with Congress and the new Securities and Exchange Commission to help shape the Investment Company and Investment Advisers acts of 1940—the cornerstones of our modern regulatory system. And the industry formed the National Association of Investment Companies, the forerunner to the Investment Company Institute, with a mission to work with regulators to ensure that funds and their advisers would pursue a fiduciary role—a role that puts investors first.

The result, as it has evolved over seven decades: A strong system of regulation, and funds that offer an array of important investor protections. When investors buy a mutual fund, they receive a diversified, professionally managed portfolio that's transparent and liquid. Unlike many other financial products, that fund has a simple capital structure and limited use of leverage. Its assets are held under strict custody, and their value is marked-to-market every day, following strict pricing discipline.

These protections are backed by stringent disclosure requirements and overseen by a strong system of governance, with independent directors serving as watchdogs for the interests of investors.

That system has allowed a tremendous range of innovation, creating products that serve a wide range of investor needs—money market funds, index funds, lifestyle and target date funds, and exchange-traded funds.

It has fostered better shareholder service and flexible arrangements that help investors pay for those services through a variety of load and fee structures.

It has fuelled the spread of funds in self-directed retirement plans, with mutual funds accounting for more than 45 percent of assets in defined contribution plans and individual retirement accounts.

And it has fostered growth and competition—cutting the cost of investing in stock and bond funds by half since 1990. Little wonder that funds now serve more than 50 million households—up from around 5 million in the 1980s.

This system of regulation, oversight, and fiduciary duty has been tested. And it carried our investors through the deepest bear market since the 1930s.

What's more, our investors have stuck with us.

In every market downturn over the past 20 years, pundits and the experts in the media have predicted that mutual fund investors would panic when their mutual fund shares lost value. They looked for fund investors to run for the exits in 1987 ... in 1990 ... in 2000. And these experts were primed for a monster rush out of stock mutual funds during the steep market downturn we suffered since the fall of 2007.

Instead, what has happened? After 1987's Black Monday, outflows from stock funds totaled just 5 percent of assets. After the tech stock bubble burst in 2000, fund investors held steady. And throughout the extraordinary turmoil of the last 24 months, investors in long-term mutual funds stood firm. From the market's peak in October 2007 to the recent low in March 2009, while the Standard & Poor's 500-stock index fell an incredible 56 percent, stock mutual funds saw outflows of only 5 percent of their assets.

In other words—people who invest have been a lot calmer than the people who just write about them.

That could be because the people who invest don't have to meet a daily deadline. Fund shareholders consistently tell us that they are long-term investors. During the worst financial storm in generations, they confirmed it.

Can we trace that stability to our strong system of regulation? I can't prove that proposition—but I believe it wholeheartedly.

Of course, regulation alone is not enough. The strongest rules can be thwarted or sidestepped.

That's where the fiduciary culture of our industry comes into play. We recognize that our industry runs on investor trust, and that we must earn and keep the trust of investors every day of every year. We must remind ourselves constantly of our duty to investors.

As the legal counselors to this enterprise, you are keepers of that culture. You are among those who must be sure that your firm, or your client, is always approaching issues with one question in mind: “What is best for our investors?”

Now—you are not the only guardians of that culture. In fact, if I were addressing a conference of fund marketing professionals, I would tell them, “You are keepers of the flame of the fund industry’s fiduciary culture.” And if I were speaking to an audience of portfolio managers, I would say, “You are keepers of the flame of the fund industry’s fiduciary culture.” So too for the trading desk, or the operations staff—or the call center.

All of us, throughout our firms, throughout our industry, need to nurture that flame ... to preserve that culture ... to keep our eyes fixed firmly on serving the needs of our clients—the investors.

Each of these professions, of course, approaches that task from a different angle. And when there’s a thorny issue at hand, one that tests the fiduciary culture, there’s usually a lawyer—or two, or a dozen—in the room. How do you, as the legal adviser, look at these matters?

First and foremost, of course, you must always apply the law properly, and never bend your interpretation of the law to meet a business need.

I would argue, however, that you have also a special burden to think beyond your legal rulebook and to understand the many perspectives that your colleagues bring to an issue.

To do that, you need to learn the business of your firm. You need to understand marketing and investment management and trading and operations well enough that you can counsel your colleagues, and help them shape their ideas to both meet the legal requirements and advance the business goal they’re trying to reach.

Of course, there are times when the law department has to exercise the legal veto. Saying “no” is the toughest part of your job—but it’s a necessary part.

The great counselors, however, are those that know how to work toward “yes”—a “yes” that serves the interests of the business and, most important, the shareholders. To achieve that, those advisers make themselves a full partner in the dialogue on these important decisions. They learn what’s beyond the black-letter law so that they can have command of the business issues of our industry.

Many of you here are from law firms. It’s especially tough for outside counsel to say “no” to a client, to say, “That decision may meet the letter of the law, but it’s not true to the fiduciary culture that your company wants to preserve.” For outside counsel, it’s especially important to master the broader knowledge that will enable you to shape decisions so that they’ll serve not just the client, but the ultimate customer—the shareholder.

Those skills are going to be put to the test in the months ahead. Congress, the Administration, the Federal Reserve, the SEC—they all have plans to reshape the regulatory system. As fund companies and as an industry, we'll have to respond, interpret, and adapt.

As you approach this challenge, let me just leave you with one final message: Remember the shareholders. As individuals, as companies, and as an industry, we cannot lose our way if we always put investors first. That is our culture, now and for the future.

Thank you for honoring me with your time and attention.

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