IDC Independent Directors Council

Promoting Excellence in Fund Governance

Investor Protection Priorities for the New Year

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Remarks Before the Investor Advisory Committee of the US Securities and Exchange Commission

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As prepared for delivery.

Good morning, and thank you very much for the opportunity to speak again before the SEC's Investor Advisory Committee.

Today's topic is investor protection priorities for the New Year. I would like to raise four priorities for this committee to consider:

1. Shortening the securities settlement period from T+3 to T+2
2. Enhancements of NMS plan operating committee governance
3. Shareholder report delivery, then disclosure, reform
4. A harmonized standard for financial advisors when providing personalized investment advice

The Investment Company Institute has a particular, and unique, interest in protecting the interests of investors. ICI's members are regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. Our members manage more than $18 trillion in total assets in the United States, serving more than 95 million US fund shareholders, along with $1.6 trillion in assets in other jurisdictions.

If I were to poll our members about next year's priorities, I am sure we would receive consistent feedback: to give us an opportunity to implement all the rules that have been imposed on us. The SEC's new data reporting, swing pricing, and liquidity risk management rules alone will require huge expenditures and years of work to implement fully. They were adopted in the aftermath of two rounds of money market fund reform, as well as many other rules applicable to the fund industry adopted by other regulatory agencies.

Allow me to give you a sense of the scope of regulatory change. Just in the past fiscal year—the 12 months ending in September—ICI submitted 111 comment letters globally, totaling more than 1,600 pages. That is almost one letter every other working day, filed with an alphabet soup of agencies, councils, and boards in the United States and around the globe. In short, we need a breather to take time to carefully implement all the regulatory change from the past few years.

Notwithstanding the clear need for a pause on the regulatory front, one of our core missions is to advance the interests of fund shareholders. The four priorities I would like to discuss today advance that mission.

But before I turn to those priorities, on behalf of our members and fund investors I would like to take the opportunity to thank SEC Chair Mary Jo White for her exceptional leadership of the Commission through one of the most challenging and significant periods of its history. Chair White, your commitment to investor protection and robust capital markets has strengthened America's financial system, to the benefit of mutual funds' 95 million investors. Thank you for your service. You surely will be a tough act to follow.

Now, let me turn to our suggestions for this committee's priority list for the upcoming year.

Shortening the securities settlement period from T+3 to T+2. We were pleased earlier this week to provide strong, unqualified support to the SEC for its initiative to shorten the settlement period for securities transactions from trade date plus three days (T+3) to trade date plus two days (T+2). We have supported similar rule changes by the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), and several of the national securities exchanges.

Though the transition will be quite costly to many industry participants, this shortened settlement period will improve the efficiency of the US securities markets, align US markets with other global markets, and promote financial stability in the United States.

Simply put, action by the SEC and other regulators is critical to achieving the shortened settlement period. We commend the SEC for the leadership demonstrated by its shortened-settlement-period rulemaking. We also appreciate the committee's support for shortened settlement periods, though we recognize that the committee prefers an even shorter settlement that, today, is not attainable.

ICI's Chief Industry Operations Officer Marty Burns and his counterpart at the Securities Industry and Financial Markets Association (SIFMA) co-chair a group that has been working closely on this initiative with the Depository Trust & Clearing Corporation (DTCC) and other stakeholders throughout the financial services industry. Together, they have developed an industry timeline for implementing the shortened settlement period, with a target date of September 5, 2017. We remain deeply committed to carrying out that plan.

Enhanced governance of NMS plan operating committees. We also recently commented on the SEC's review of the Regulation National Market System (NMS) under the Regulatory Flexibility Act. Our letter suggests a straightforward mechanism intended to improve transparency and governance of the equities markets. Though this is a complicated topic, we have a simple suggestion: substantially enhance the governance model of NMS plans by adding representatives of registered funds to the operating committees of NMS plans. Adding these SEC-registered investment advisers—professional investors who serve the interests of retail investors—would add fairness and accountability to the market governance process.

Today, only the self-regulatory organizations (SROs) are allowed to administer the NMS plans and the key aspects of market structure they govern, often to the detriment of other market participants. For example, today there is no public accountability for the revenue generated by NMS plans, particularly those dealing with market data.

Securities Information Processors (SIPs) are the exclusive SEC-approved providers of key market data, including information on national best bids and offers, last sales, and regulatory halts. The SROs receive millions of dollars each year from operating the SIPs. The investing public depends on the efficiency and viability of the SIPs, but there is no transparency about what portion of that money is invested in the SIPs. SIPs do not publicly disclose even rudimentary information concerning the allocation of their revenue among the SROs—who operate them—or the amounts expended for maintenance or improvement.

In addition, the SIPs compete with the exchanges' proprietary, revenue-generating market data offerings, meaning that exchanges stand to benefit—at the expense of other market participants—from slower SIPs that cannot challenge proprietary feeds.

Enhanced governance and transparency is especially important in an area like this, where there are obvious conflicts of interest. We need to add professional, SEC-regulated fund managers—whose incentives are aligned with retail investors—to the NMS committees that oversee the SIPs and other market functions. Doing so would promote greater accountability of the governance structure of the national equity markets.

Shareholder report delivery, then disclosure, reform. When I appeared at the last meeting of the SEC's Investor Advisory Committee, I urged the adoption by the SEC of proposed rule 30e-3, which would greatly enhance the use of the internet to deliver shareholder reports. Though I will not revisit that full discussion, I would like to remind the committee that adoption of that rule—including some changes ICI has recommended—would save investors more than $1 billion over several years.

Shareholder report delivery is almost universally a fund expense, so all the costs and savings for delivery are passed on to fund shareholders—not fund managers. We were terribly disappointed when the SEC missed an opportunity to adopt the rule a month or so ago. We continue to urge the SEC to adopt proposed rule 30e-3.

The SEC must also—distinct from its decision about rule 30-3—direct FINRA to reform the rules about brokers' charges for shareholder report delivery.

As we discussed at the last meeting, the leading service provider for delivery to broker-held accounts operates essentially as a for-profit market utility. Yet there is no oversight of this company. We believe that FINRA—as the primary self-regulatory organization for the broker-dealers that hire this company—must step up and provide effective oversight to protect investors. This committee should demand no less and should voice its support, at a bare minimum, for a fresh FINRA review of the fees that fund shareholders pay for shareholder report delivery.

At the last meeting, we also discussed the need for reform of shareholder reports themselves. I said at the time—and it remains true today—that ICI stands ready to work cooperatively with the SEC and this committee to promote new shareholder report disclosure. In crafting any new rules for shareholder reports, the SEC has an opportunity to unleash the creativity and ingenuity that the fund industry can provide. We have an opportunity here to provide investors with more effective disclosure while saving them money. We must not miss that opportunity.

Harmonized standard for financial advisors when providing personalized investment advice. My final topic is a significant one: the standard that applies to personalized investment advice about securities. As a starting point, ICI's members already operate as fiduciaries. The regulated fund industry has a long, rich history of fulfilling fiduciary principles in support of fund investors.

We remain concerned, though, about the Department of Labor's recent, very cumbersome "conflicts of interest" rulemaking. The proposal is deeply flawed.

There are several explanations that are worth heeding. First, the rulemaking misguidedly established a fiduciary standard of conduct through an exemption, leading to unwieldly conditions and private contractual remedies. Second, and perhaps most problematic, the premise for the rulemaking was based on an unsound economic analysis that made up theoretical harms to retirement savers and ignored the very real harms to those savers from the operation of that rule.

We're concerned that the DOL rule will drastically limit retirement savers' ability to obtain the guidance, products, and services they need to meet their retirement goals. We're also concerned it will increase costs, particularly for those retirement savers who can least afford them.

A better approach could lie here at the SEC. The SEC has an opportunity to provide investors with a uniform standard of conduct that is not limited to retirement accounts. Indeed, ICI and its members strongly support the principle that underlies the DOL's proposal—that all financial advisers should be held to act in the best interests of their clients.

Though I do not seek to diminish the significance of the task, a sounder approach would have been—and, in 2017, *should* be—for the DOL and the SEC to work in concert to issue a harmonized conduct standard for financial advisors that promotes the best interests of *all* investors, not just those saving for retirement.

Thank you very much for the opportunity to speak with you again. I welcome any questions you might have.
