

ICI Commentary in Wall Street Journal Looks at Funds a Year After Market Timing, Late Trading Investigations Began

Honest Funds

by Paul Schott Stevens

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Over the past year, since the announcement of Eliot Spitzer's settlement with Canary Capital Partners, mutual funds have been the subject of intensive and federal and state investigations. Numerous fund companies, as well as broker dealers and hedge-fund advisers, have been implicated in wrongdoing. Fund sponsors have paid billions in fines and restitution.

To its credit, the SEC has moved swiftly and surely to develop an array of new rules -- addressing market timing and late trading, the abuses at the heart of the scandal, as well as governance, disclosure, and other practices. Committees in the Senate and the House have considered mutual-fund issues in an ongoing series of oversight hearings that are without precedent in the history of the modern fund industry.

From the outset, industry leaders, too, recognized this for what it is -- the worst scandal to hit mutual funds in more than 60 years. We made no excuses. We did not seek to minimize the problems, or to shift the blame to a few "bad apples." Instead, we called for tough law enforcement, restitution, strong new regulations, and an SEC well resourced to protect investors. A year later, we are working hard to realize the full potential of the reforms adopted by the SEC.

We recognize our collective stake in the outcome of government and industry efforts to prevent conduct that betrays the trust of fund investors. Confidence is a plant of slow growth. Americans' confidence in mutual funds had grown over many years -- nurtured by a reputation for integrity. It flowered only in the past 25 years, to transform funds into the second largest financial intermediary in the U.S. Today, 91 million people entrust \$7.4 trillion to mutual funds. In a business where our

investors can redeem their shares any given day, their continued loyalty is the best indicator of our success.

If slow to grow, confidence can be quick to wither. The scandal has been felt keenly because it has put investor confidence at risk. Mutual funds remain the best means by which average Americans can save and invest to meet their long-term financial objectives. Mutual fund investing is far too important a financial tool for them to lose.

From this perspective, the events of the year past provide some reassurance. Our legal and regulatory system is working as designed, to identify and correct misconduct, to prevent it from recurring, and to hold investors harmless. Fund shareholders expect and deserve no less. Strong, corrective market forces are at work, too. Fund companies implicated in the scandals have paid a high price in lost market share and investor loyalty. Even honesty, it has been said, is a financial speculation -- and companies with reputations intact clearly have benefited.

Considerable progress already has been achieved in rooting out abusive trading in fund shares, even as the SEC continues its work on new rules for this purpose. Concerted efforts by mutual fund companies themselves are an essential part of the equation.

To eliminate the potential for trading abuses, however, funds and their distribution partners will need to work closely together. More than 80% of stock and bond mutual funds are sold to investors through third parties, including entities that are not regulated by the SEC or the NASD. As the penetration of mutual funds in our markets would imply, there are thousands of institutions -- including broker-dealers, banks, retirement plans, insurance companies, and investment advisers -- through which investors acquire and hold fund shares. We all have a strong, shared interest in protecting the vast majority of fund shareholders from the very small percentage who would profit from abusive trading.

At some point, the enforcement docket will be cleared. Sooner still, the SEC will have completed the comprehensive reforms charted by Chairman William Donaldson. For funds, their advisers, and boards, however, the tasks will continue. Implementation of the SEC's new rules will take time and diligent effort. But at its core, our response to the mutual fund scandal that unfolded a year ago has to do with what we expect of ourselves as fiduciaries and what our shareholders have a right to demand from us.

The complete answer to these questions does not lie in any statute or rule, compliance guide, or policies and procedures -- however important these may be. The answer resides in the strength of our firms' fiduciary cultures, of our commitment to ethical practices, and to serving the interests of fund shareholders.

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