

2003 General Membership Meeting: Chairman's Remarks

ICI Chairman's Remarks at the 2003 ICI General Membership Meeting

by

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Good morning. It is a pleasure to address you today at our annual General Membership Meeting.

Before I begin, I'd like to thank Rob Gordon and his GMM planning committee, as well as Matt Fink and the Investment Company Institute staff, especially Tom Simmons, for providing a truly outstanding program.

The past 12 months have been filled with great challenges for our nation, our industry, and our shareholders. Given these events, the theme of this year's meeting, "[Helping Investors Meet Today's Challenges](#)," is especially appropriate. Our strong tradition of integrity continues to unite us and strengthens our determination to help our shareholders meet the challenges of today and tomorrow.

The word "integrity" has been in the theme of every recent General Membership Meeting for one simple reason: Integrity and the trust it engenders on the part of our shareholders is the basic foundation of our business. Our shareholders trust that their mutual funds are being managed with their best

interests in mind. In good times and challenging times, whether they are saving for their own retirement or their children's education, our shareholders trust that we will be there for them. And trust is the principal reason our relationship with investors has not been broken by the bear market in equities of the past three years.

This morning, I would like to make some general comments and observations on the state of our industry. Then I want to focus on how the core features of mutual funds—diversification and professional management—benefit our shareholders, especially in challenging times. And finally, I would like to offer some thoughts on how our shareholders have long benefited from independent scrutiny of mutual funds, and how that scrutiny can be made more effective.

The State of Our Industry

Since we last met one year ago, our industry and our investors have faced the harshest financial environment that most have ever seen. The U.S. stock market, weighed down by revelations of corporate accounting scandals and downward revisions to earnings forecasts, slipped for the third consecutive year. The bear market in stocks, combined with interest rates at their lowest levels in more than 40 years, left many investors with investment returns that were well below even the modest pace of inflation.

Despite this particularly difficult and challenging time in the history of the nation's financial markets, I believe that our industry continues to serve America's 95 million mutual fund investors quite well. Today, mutual funds provide more useful information, investment options, and services to our shareholders—at much lower cost—than ever before. In fact, the costs are both lower and better disclosed for mutual funds than any comparable financial service used by Americans.

In terms of length and severity, the current market environment has been the worst since the Great Depression. While the prolonged bear market has been difficult for our shareholders, [most fund investors are staying put](#). We continue to manage nearly \$6.3 trillion on behalf of about half of all American households. There have been no mass redemptions and no panic by our shareholders. In fact, since the bear market began, the number of [American households owning mutual funds](#) has remained stable. Last year's outflow from equity mutual funds—the first in 14 years—represented less than one percent of average annual assets compared with 8 percent in 1988.

The resiliency of our shareholders is a reflection of the fund industry's ongoing efforts to help keep investors educated and informed. In the five years before the bear market began, the stock market, as measured by Standard & Poor's 500 Index, rose more than 20 percent annually. These unprecedented gains undoubtedly gave some investors the impression that the only direction the stock markets travel is up.

The Institute sought to counter this impression at the height of the market's bubble by [cautioning investors](#) that extraordinarily high equity returns were unsustainable. More recently, as bond prices

have been boosted by interest rates at historic lows, we have cautioned investors about the [impact rising rates will have on bond prices](#).

Our industry must persist in conveying these messages. Market conditions may change, but our message to investors must always remain the same. Setting realistic goals, understanding the relationship between risk and reward, and recognizing the benefits of diversification and regular investing are pillars of our industry's long-standing investor education programs. We must continue to urge investors to temper their expectations in strong markets and not to lose faith in weak markets.

Obviously, when we are in the grip of a stubborn down market, gains for investors in the stock market will be rare. However, it is in these markets that the core features of mutual funds—diversified portfolios and professional management—and the industry's history of educating investors best demonstrate their effectiveness.

Our [equity fund investors](#) appear to understand the importance of diversification. Although many have suffered losses, the diversification inherent in mutual funds has helped cushion fund shareholders from the impact that a single, poorly performing investment can make on their overall portfolio, or mix of investments.

Just as our message to investors has remained constant, we have never wavered in our belief that tough and meaningful investor protection is essential to investor confidence and our industry's well being. We have continued to cooperate with regulators and to embrace new ideas—including some from our harshest critics—which we believe would bring about more effective oversight, and better serve investors.

For example, we listened and acted when commentators said the prospectuses we offer all mutual fund shareholders were too difficult to understand. We embraced this challenge, and with our strong support, the SEC enacted [major disclosure reform](#) that transformed prospectuses into readable, plain-English documents.

We listened and acted when observers said our annual and semiannual shareholder reports could be enhanced to help readers make informed investment decisions. Again, with strong industry support, we endorsed the [SEC's initiative](#) to improve the quality of information about fund portfolios presented in shareholder reports by permitting these reports to include a streamlined schedule of investments that identifies the fund's 50 largest holdings and any other holdings that account for at least one percent of the fund's net assets, and require all shareholder reports to provide graphic representations of portfolio information.

When regulators said our shareholders needed more information about fund [fees and expenses](#), we acted by strongly supporting the SEC's proposal to strengthen the unparalleled level of disclosure already available to America's mutual fund shareholders by requiring more information about ongoing expenses in fund shareholder reports. This information will help our shareholders understand the

impact of expenses on fund returns and compare expenses among funds without imposing the substantial costs and burdens on funds and intermediaries.

We listened when the SEC challenged our independent directors to do an even better job of protecting shareholders. And we acted by convening a blue-ribbon industry advisory group, upon which I had the honor of serving, to recommend a series of [best practices](#) to strengthen the system of governance that protects the nation's 95 million mutual fund shareholders—best practices that only now are being introduced to corporate America.

In the last several days, I have attended three graduations—at the seminary where my wife Heather serves as a trustee, at my former law school, and my niece's graduation from college. The last one gave me an opportunity to spend quality time with my older sister, which, as usual, reminded me how important her comprehensive, and regular criticism of me has been to my personal development. I've often said "show me a successful person and I'll show you someone with an older sister."

Like younger siblings, the mutual fund industry has benefited from numerous and effective critics over the years—but they've never been more active than in the recent down market. Former SEC chairmen, members of Congress and their staffs, academics, Bards of Omaha, journalists, television talking heads, competitors—even a saint with his own statue—have all weighed in about our perceived failings. We've heard high-level rebukes, mid- and low-level rebukes, and rebukes where we couldn't even figure out what they wanted us to do. It makes me wonder what life would be like if we'd actually done something wrong.

Funds need effective critics for the same reason we need effective directors and regulators—to bring a fresh outside perspective to everything we do and enforce the very highest standards throughout our industry. As Michael Billington, the leading critic of the London stage for more than 30 years, said: "artists need someone to stand outside their work and weigh it up." Criticism, he says, "is part of any healthy debate on the state of the culture. If you just have plays and ballets and concerts without assessment, you end up with a sterile culture."

Siblings and art critics share one essential characteristic—they both love the subject of their criticism and desire only to improve it. For most of my nearly 30-year career with the mutual fund industry, I've believed that that was also true of our critics—that they only had the best interests of shareholders at heart.

But lately I have not been so sure about some of them. When criticism is unfair, uninformed, or unbalanced, or when critics are motivated more by a desire to sell publications or competing products, or to gain publicity or political advantage—they become too easy for us to ignore and we lose an important opportunity to listen and improve. To paraphrase a familiar analogy—they become watchdogs whose bark we don't hear anymore.

As I said earlier, I attended three graduations in the last several days. I heard moving addresses about world peace, the importance of public service, and the need to stay flexible in your career plans so you can hear God's calling. But the one that moved me the most had the simplest theme—Stand Up. In words much more eloquent than mine, the speaker repeatedly exhorted the law school graduates to stand up—stand up for the weak and those in need; stand up against injustice; stand up for what you believe and what you know is right even — or especially — if it is not the popular view.

As I listened to those words, I reflected on our recent experience of standing up against one part of the [proxy disclosure rules](#)—the provision that required disclosure of every individual vote. We knew the political environment and we knew the power massed against us, we knew the cost in public relations, and we even knew what the ultimate outcome would be. But we stood up for our shareholders against a rule that we believed would politicize the voting process and ultimately weaken their voice in corporate governance. We were motivated solely by the interests of our shareholders, and only slightly influenced by the fact that the unions proposing the rule for mutual funds refuse to disclose their own proxy votes.

I am proud that we took a stand and I pledge that this painful experience will not cause us to back down the next time we encounter regulation that is popular but not productive – and that could actually harm our shareholders.

And we will continue acting in the best interests of our shareholders. For example, this year we will stand up for the [next generation of improvements to our nation's retirement and education savings systems](#) to enhance long-term savings and investment opportunities for all working Americans.

We will also stand up to ease the concerns of millions of fund shareholders frustrated by tax rules that force them to pay tax on capital gains when they do not sell shares in their funds. We will urge Congress to approve [legislation](#) to allow our shareholders to defer all taxes on capital gains distributions so long as those distributions are reinvested in additional fund shares.

And we will continue to stand up for reform in the governance of corporate America, reform of the securities markets on which we depend, and broad reform of the financial services industry in which we operate.

Closing Remarks

In closing, let me remind us that through the Institute we have a 63-year history of strong leadership in advancing the interests of mutual fund shareholders before Congress and across the nation. Decades of industry growth and investor confidence in the mutual fund industry are reflections of the Institute's high standards of excellence.

I appreciate the industry's broad-based support of the Institute's many efforts and I respect our members' willingness to put the best interests of our shareholders above all else. With your participation and support, our industry will continue to stand up and speak with a united voice before

legislators, regulators, and the public.

As I recently told federal legislators, the fact that the typical shareholder who holds mutual funds today is paying far less than the average fund charges is compelling evidence that our industry's practices—the funds we offer, the services we provide, and the fees we charge—are serving tens of millions of fund investors faithfully and effectively.

In these challenging times we must continue to earn our shareholders' trust and maintain it every day by remaining fully committed to the principles and mission that have served mutual fund investors so well for so long. It is equally essential that we continue to be open to new ideas—from within and outside the industry—that will allow us to provide even greater service and benefits to our shareholders.

Finally, I would like to say that it is my honor and privilege to serve as your Chairman. I am especially grateful to have been selected to chair the Institute during such a difficult period and hope that my leadership can help us emerge even stronger from the recent challenges. I'd like to take this occasion to thank the ICI staff and my fellow Board members for their professionalism, integrity, and support.

Thank you and enjoy the rest of the meeting.

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