IDC Independent Directors Council
Promoting Excellence in Fund Governance

What Lies Ahead for Fund Regulation?

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Luncheon Keynote, given at:

The SEC's New Fund Reporting and Liquidity Rules: What Do They Mean for the Fund Industry?

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As prepared for delivery.

Good afternoon, and thank you all for being here. I hope you enjoyed your lunch and the conversations at your tables.

More important, I hope you are benefiting from the information and insights that our speakers and panelists are delivering today. Even before the Securities and Exchange Commission completed work on these new rules in October, those of us at ICI knew that we needed to provide all possible support to our members in implementing the significant changes in policy and operations that the rules would impose.

This conference is a start for our efforts, and we have much more ahead of us. Throughout 2017 and into 2018, ICI staff and several member working groups will be devoting our collective resources to help funds in implementing these rules. As always, we're pleased with the great contributions from our

members.

I'd like to express ICI's deep thanks to our speakers and panelists, including those from the SEC, for their participation. A special thanks to Tom Faust, a member of the ICI Board of Governors and CEO of Eaton Vance Corp., for kicking off the conference this morning.

And let me once again express ICI's appreciation and gratitude to SEC Chair Mary Jo White, who announced earlier this week that she will step down from the Commission in January. Chair White provided exceptional leadership through one of the most challenging and significant periods in the SEC's history. The expertise, experience, and open process that the Commission has brought to asset management issues under her leadership—including the rulemakings we are here to discuss today—will strengthen regulated funds, to the benefit of their investors. We thank her for her long service to the nation, and wish her Godspeed in her future endeavors.

I am just back from a quick trip to Brussels. You won't be surprised that there, as here, people want to know:

- How did Donald Trump capture the White House?
- How did the Republicans retain both houses of Congress? and
- What will this mean?

I'll leave the first two questions to the pundits and the pollsters—although I hope they'll display genuine humility in their responses, as seems warranted by their recent track record.

On the last question, however, I'd like to offer some thoughts—very preliminary thoughts—from ICI's perspective on how the change in political fortunes will affect the course of financial regulation. I'll focus particularly on the implications for funds and their managers, and the investors they serve.

For context, let's look at some numbers. I'm sure you're aware of these trends, but the specific data may surprise you.

The great financial crisis peaked eight years ago. The Dodd-Frank Act was passed six years ago. But before the election, the wave of rulemaking unleashed by those events showed no signs of cresting.

In our past fiscal year, the 12 months ending in September, ICI submitted 111 comment letters, 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.

I cannot remember a time in the 23 years since I first worked at ICI when our regulatory agenda has been more extensive, or more consequential for the future.

This is not just affecting the fund industry. Take a look at the Federal Register. It published 80,260 pages of executive orders and proposed and final regulations in 2015. And as of Tuesday, the 2016 Register was within a few hundred pages of that total—with every indication that in its final year, the

Obama Administration will top the record pace of 2010, the immediate aftermath of the financial crisis.

Two weeks ago, there seemed to be little hope that this tide would turn.

Now, President-elect Trump, Speaker Ryan, and Majority Leader McConnell have pledged to stem, or even reverse, that momentum.

Clearly, the results in the presidential election and many of the Senate races were close. There are many contentious issues and much debate ahead of us.

But in the area of financial regulation it seems clear to me—and to many thoughtful policymakers on both sides of the partisan aisle—that we need to pause and take stock.

We need an opportunity to re-examine the appropriateness of many ongoing regulatory initiatives—including the Department of Labor's fiduciary duty rule and the FSOC's authority to designate non-bank financial institutions as "systemically important," to name but two.

And we need to critically assess the need for additional rules that are in the pipeline.

Elections have consequences—and now, we have that chance.

Fortunately, ICI and its members are prepared for this opportunity.

For 75 years, ICI has been a strong advocate for efficient, effective regulation. We have worked with lawmakers and regulators from both parties to pursue that goal. The funds that we represent embrace regulation as a necessary component for building trust among investors.

Without that trust, we could not operate. The success of our industry—as reflected in the $18 trillion in assets we manage for 95 million American shareholders—depends on sound regulation.

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 impose huge costs on our economy and our society, in the form of lost opportunities, lost innovation, and lost growth.

Here, too, ICI has established a strong track record for grounding its views in sound legal and economic analysis, industry experience, and operational expertise. That has long been our way—not just before the latest election, but for decades.

As I indicated, there are at least two areas where we hope this opportunity to pause and reconsider will benefit funds and fund investors.

The first is the Labor Department's redefinition of fiduciary duty for brokers and advisers who serve retirement savers.

Let me be very clear: ICI strongly supports the principle that financial professionals should act in the best interest of their clients when offering personalized investment advice. We have worked hard with Congress on efforts to create a unified fiduciary standard that would apply to all investors, whether they're investing inside or outside retirement accounts.

Unfortunately, the DOL chose to impose a best interest standard through a complicated, back-door regulatory regime that will impose significant new liability on those serving retirement savers. The final rule will have the effect of limiting available advice options for many savers. As a result, implementation of the rule will make it more difficult for low- and middle-income Americans to save for retirement. Small businesses, in particular, will find it more difficult to offer their employees saving opportunities.

The DOL rule was completed last April. Even then, it faced significant congressional opposition—bipartisan opposition, though the Democratic voices were muted by the White House's strong campaign in favor of the rule.

With key implementation steps for the rule looming in April, time is short for action, either by the incoming Administration or by Congress. But we would urge them to act, to ensure that savers can get financial advice that serves their best interests, yet is accessible and affordable.

The second area that deserves a thorough examination is financial stability regulation.

As it happens, I was in Japan about two weeks before the election, and I had opportunities to speak about the recent course of financial regulation. My theme was the need for a robust financial system—one with the resilience to cope with and adapt to shocks, yet with the flexibility and strength to serve the crucial functions of capital formation and intermediation needed to promote economic growth.

Since the financial crisis, policymakers instead have pursued a single-minded goal of financial stability. They have sought, in other words, to wring all sources of risk out of the financial system. Unfortunately, this overriding goal of "stability" threatens to put at risk other objectives—such as growth, and innovation, and opportunity—and make economic and social conditions worse, not better.

Now, no one would deny that the great financial crisis spotlighted weaknesses that cried out for reform. Our financial system needed to be stronger. Much effort has been devoted to this objective, with considerable results to date, and ICI has supported that process.

But it is equally clear that the regulatory structure that governs funds served our financial system well when the banking system started to come apart in the fall of 2007.

Funds that invest in stocks and bonds rode out the financial crisis without incident. The value of fund shares fell sharply, in line with the markets in which they invested. But these funds did not experience investor flight, heavy redemptions, operational disruptions, or other problems that could have exacerbated the financial crisis.

In fact, it's fair to say that regulated stock and bond funds were among the most robust segments of finance during those dark days.

So it is ironic that the concept of "shadow banking"—especially as applied to asset management and regulated funds—has informed so much of the work of the US Financial Stability Oversight Council, or FSOC, as well as the multinational Financial Stability Board, or FSB. And that work has been driven largely by conjecture and academic speculation—by theories of risks based on fund investor "herding," "first-mover advantages," and "fire sales."

In fact, the 76-year history of the modern fund industry—with the numerous twists and turns that markets have taken over that span—disproves those speculations.

- Fund investors do not "run."
- Funds do not create "illusions" of liquidity.
- Funds do not fail catastrophically, as banks do.

Instead, the empirical record demonstrates that regulated funds pose no threat to financial stability. And there is no reasoned case to be made that funds need to be designated as systemically important financial institutions—like banks—or to be subjected to capital standards, macro-prudential rules, or other bank-style regulations.

Building on this empirical evidence, ICI and its members have pursued two broad objectives:

- We have sought to refocus debate on financial stability in asset management, in the US and globally, onto activities and practices that affect all participants in the capital markets, rather than on designation of specific funds or managers.
- And we have sought reforms that would, at a minimum, introduce more rigor, fact-based analysis, transparency, and fairness into the FSOC designation process for all non-bank financial institutions.

On the first front, we have enjoyed some success—as attested by the fact that you are here today.

In December 2014, SEC Chair Mary Jo White took on the challenge of reforming fund regulation in a number of areas that could potentially affect financial stability. The two rules that we're discussing today are fruits of that effort.

ICI has supported Chair White's agenda. We believe that regulation of asset management should be led by regulators, like the SEC and its counterparts in the International Organization of Securities Commissions, with expertise and experience in the capital markets—not by banking regulators. And the SEC is subject to administrative procedures that ensure robust consultation with the public and the regulated industry—so that rulemaking can be informed by real-world data, experience, and perspective.

The two rules before us today show the results of that process. While the final rules impose new burdens, they are nonetheless useful initiatives.

The data reporting rule will provide ongoing, detailed information that the SEC can use to enhance its monitoring, identify worrisome patterns and trends, and potentially spot concentrations of risk.

The liquidity risk management proposal will elevate a key element of portfolio management, ensuring even greater attention from both fund advisers and boards.

We commend Chair White for her leadership on these issues, and we are grateful to Commissioners Piwowar and Stein, and to the SEC staff, for their hard work. The Commission drew upon a rich comment record to make constructive changes, improving upon its proposals so that the final rules could achieve their objectives with the least burden. The final rules are tough but fair—and that is what regulation should aim to be.

We have also sought legislation to reform FSOC and its processes. Clearly, the prospects for meaningful congressional action on that front have changed in the past two weeks. We expect reform of the Dodd-Frank Act to be among the first bills that the House will take up in January—and that reform may be sweeping. ICI will monitor it carefully.

I've identified two areas—the DOL fiduciary rule and financial stability regulation—where we are nearly certain to see a reassessment of regulation. Other areas are likely to follow.

Clearly, the environment for financial services has changed. Elections do have consequences.

But in the course of 76 years, ICI has seen many changes in Congress and the White House. Always we seek not so much to appeal to the party in the majority, but to assemble a majority in Congress of members who want to serve the interests of fund investors.

Those 95 million fund investors are Republicans, Democrats, Libertarians, Greens, and independents. They all turn to us for the same reason—to achieve their financial goals. Whatever the party in power, helping them achieve those goals is the imperative that drives our work.

Thank you, and I hope you enjoy the rest of the conference.

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