



REMARKS OF  
J. CARTER BEESE, JR., COMMISSIONER\*  
U.S. SECURITIES AND EXCHANGE COMMISSION  
TO  
THE INVESTMENT COMPANY INSTITUTE TRAINING CONFERENCE  
WASHINGTON, D.C.  
JUNE 17, 1992

- \* The views expressed herein are those of Commissioner Beese and do not necessarily represent those of the Commission, other Commissioners, or the staff.

*U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549*

Good afternoon. It is a pleasure to be here. As you just heard in that overly gracious introduction, up until a few months ago, I spent 14 years dealing directly with investment companies in the marketplace. Now I am on the other side of the table, and as a member of the government agency primary responsible for regulating the investment company industry, I very much welcomed the opportunity to participate in this Conference.

During the next three days, I expect that you be hearing quite a bit about the Investment Company Act of 1940. The '40 Act, as it is commonly known, established the federal regulatory system that governs investment companies, and it has been hailed by your own ICI as a model of effective legislation. But before you become immersed in the specifics of these rules and regulations, I think it is beneficial to take a step back and examine the evolution and growth of this industry.

The past fifty years of development offers important insights into the types of future efforts that are needed to insure continued success in the investment company industry. Today, I would like to share with you some of these insights, and discuss what activities

you, as industry participants, can engage in to foster further success. Then, I would like to discuss what steps we, the SEC, have been undertaking to help the regulatory system evolve with the industry and become more flexible and more efficient to deal with the opportunities and challenges presented by today's more modern and inclusive financial markets.

After decades of development, the investment company industry has emerged as a powerful force in the financial services business, and seems poised to ascend to even greater heights. Combined investment company assets stand at over \$1.5 trillion, with over one in four American households investing in investment companies -- either directly or indirectly through other investment vehicles such as pension plans. To put this into perspective, only one in five Americans holds a passport, -- which means it is easier to invest in this country than to leave it.

Moreover, the next few years will be a watershed time for investment companies. We are witnessing daily the growing institutionalization of the capital markets. In fact, the institutional demand for collective investment products is a major catalyst behind the recent growth of the investment company industry. In 1970,

institutional assets accounted for only 11% of investment company assets. Now they account for over 25%. Additionally, investors are altering their saving and investing practices, and the reverberations from the shifts in these historical patterns will be felt not only in your industry, but throughout the entire spectrum of the financial markets.

However, while the potential for success breeds optimism for the future of the industry, experience tells us that a certain degree of prudence is warranted.

In today's low-interest rate environment, throughout our nation millions of Americans are searching for alternative investments for their savings accounts, their certificates of deposits and their treasury securities. Buying into a rising stock market has emerged as a leading choice. This situation is somewhat similar to the 1920's, when investors of modest means saw businesses prospering and common stocks reaching record highs and thus sought to participate in the stock market. To satisfy this demand, investment bankers, brokers and others began to actively promote the investment company concept and to distribute investment company securities.

Thus was born the forerunner of the modern investment company industry. Unfortunately, many sponsors of these early investment companies failed to observe principles of fiduciary duties, and many holders of investment company securities lost large sums of money as a result of deceptive practices. This loss was particularly harsh for the small, unsophisticated investors for whom the industry seemed so well-suited. In the aftermath of these and other losses that continued during the 1930's, Congress decided to take action to regulate the previously unregulated investment company industry.

In 1940, Congress approved The Investment Company Act without a single negative vote. The reason for such a remarkable accomplishment is simple. Because instances of abuse affected the reputation of the entire industry, investment company representatives were eager to develop a regulatory structure that would curb abusive practices and establish uniform standards. In today's de-regulatory environment, it is almost inconceivable that the SEC began regulating this area at the urgent request of industry participants.

From its inception, the Investment Company Act was the product of collaboration and compromise between the investment

company industry and the Securities and Exchange Commission. As with all legislation, there were, of course, objections to the Investment Company Act bill as it was first introduced. However, a small group of industry representatives quickly emerged to work with the Commission and the Congress to resolve major differences. In fact, I have it on good authority that the negotiations took place at another hotel just a few blocks away from here, at the Hay Adams.

As finally adopted, the Investment Company Act incorporated the main objectives of the original legislation, while also responding to the chief criticisms. Almost as significant, the creation the '40 Act initiated a partnership between the SEC and the industry that has proved to serve all parties, -- but most importantly, the investors --, quite well. Like any partnership, there are differences of opinion, but I hope that this tradition of cooperation will continue during my tenure on the Commission. Indeed, I am greatly interested in this industry, and look forward to working with you to continue to build upon the accomplishments already achieved. It is important for me to know your concerns, and I hope we can address some of them in the question and answer period following my remarks.

Not surprisingly, the industry has undergone dramatic and profound changes since the Investment Company Act was adopted. In 1940, there were only 436 investment companies in the United States holding slightly more than \$2 billion in assets. Today, as you are well aware, there are over 3,600 investment companies that hold approximately \$1.5 trillion in assets. Even more profound, there were only 68 mutual funds in existence in 1940. Now there are in excess of 3,000 , which provide a critical link to the securities markets for tens of millions of Americans.

Much of the growth in investment company assets has occurred during the last decade. This extraordinary growth in fund assets is not without precedent. In the so-called "Go-Go" stock market of 1960's, investment companies experienced a similar boom, although that market rise did not herald uninterrupted prosperity for the fund industry. In fact, there was quite a downturn in the industry's fortunes in the 1970's, and the causes of that downturn merit examination.

During the "Go-Go" era, so-called "Go-Go" funds sought to attract investors through spectacular short-term results that were achieved at the expense of sound fund management. While

investment companies had generally been regarded as long-term investments, investors were drawn to the "Go-Go" funds on the basis of quick returns - - and perhaps without fully appreciating the risks associated with these investments. Funds were also ill-equipped to handle the record number of investors coming into the market in the 60's. Funds provided little or no shareholder services, leaving investors essentially to fend for themselves after their initial investment.

In the late 1960's, a bear market set in - - and, as could be expected, the "Go-Go" funds that had risen faster than the market, declined in the same manner. Surprised by this result and frustrated with chaotic or non-existent fund services, investors became dissatisfied with the entire industry, essentially shunning fund investments until this latest acceleration in asset growth. As in the 1930's, investors again felt abused, and failures to keep investors informed and to maintain their confidence by providing adequate services essentially tainted the whole industry for over a decade.

Some have suggested there is a parallel between the "Go-Go" era of the 1960's and the current environment. While it is true that investors have been attracted to high yield growth funds as interest



rates have fallen, the fund industry is now clearly more diverse, in many instances providing a family of funds for investors to utilize. Moreover, funds today are unquestionably better equipped to meet shareholder servicing needs. Also, with the increased media attention and a greater supply of better industry information materials, investors arguably are more informed when selecting particular investment vehicles.

Still, I believe that the emergence, or re-emergence, of mutual funds as the investment vehicle of choice of the American public underscores the responsibility of industry participants to exercise caution and maintain a continued commitment to their investors. In my view, this responsibility can be most effectively discharged in two ways:

- first, by continuing to conduct yourselves in accordance with the highest ethical and appropriate legal standards;
- and second, by continuing the efforts to educate yourselves and your customers about the industry and the products and services you offer.

Unlike other businesses, where product innovation or customer service is the primary driving force underlying profits, success in the investment company industry is ultimately achieved by accomplishing one goal: maintaining investors' confidence. More than securities or investments, the mutual fund industry sells trust. Performance is important, but yields and stock prices will fluctuate up and down as the financial markets, like the tides, inevitably rise and fall. I can assure you, however, that if investors lose faith that investment companies are a good place to put their money, your industry will suffer serious consequences.

For the most part, investment companies have operated with remarkable safety, free of the fraud and scandals that have appeared in other segments of the financial markets. Even more impressively, this protection has been provided to investors at the same time that they have been afforded an opportunity to purchase a constantly expanding, diverse range of products that allow participation in capital markets both at home and abroad. However, investor trust must be maintained, and in my view, can be maintained, if all participants in the industry understand and appreciate the responsibility each holds. One bad apple does not necessarily spoil

the bunch, but with today's increased media coverage, it will take fewer bad apples to seriously damage the industry for all.

As I mentioned, the Investment Company Act was enacted to provide important safeguards against self-dealing and overreaching by insiders, misvaluation of assets, and the failure to disclose risks to investors. In the end, however, these laws are only as good as the people observing them. You will do yourselves and your industry a tremendous service by taking whatever steps are necessary to insure that you and your co-workers continue to act within the boundaries and spirit of the law.

Education will also play an important role in maintaining the confidence of investors and insuring the continued success of the industry. In recent years, investors have faced an increasingly complex array of investment opportunities. As a result, investors are not only searching for suitable investments, but are also seeking assistance to understand their options. With the proliferation of funds and products, effective customer service will be a key ingredient in sustaining investor confidence. As the industry experience in the 1930's and 1960's demonstrated, investors lose faith when they are exposed to unexpected risks or inadequate support services.

I am somewhat concerned that during today's "good times," fund investors may be confused about the security of their investments -- or, worst yet, they may be channelled into investment products not suited to their needs and circumstances. I do not mean to imply that higher yielding investment companies have no place in the market, because clearly they do. However, it is incumbent upon you - - the industry - -to make sure that investors understand any risks associated with the products they are buying. Investors require your expertise and deserve your attention, both before and after the initial sale. By learning more about your industry, you will be in a better position to keep investors informed continuously regarding the nature of their investments.

To that end, I would like to spend a few moments discussing the SEC's recent activity in your industry.

As many of you are aware, there are a number of potential changes in mutual fund regulation on the horizon. Just last month, the Division of Investment Management, the arm of the Commission responsible for oversight of the investment company industry, issued a staff report on investment company regulation. Initiated at the

request of Chairman Breeden, the report followed a comprehensive two year examination of the investment company industry and current regulatory requirements.

The Division's report, with this nice red cover, entitled Protecting Investors: A Half Century of Investment Company Regulation, is 525 pages long. In the interests of time -- and since you are only receiving one dessert, and I'm told that my good friend Joe Hardiman covered portions of this report at your morning session -- , I will simply review certain of the highlights. I'm sure you will discuss many of the other topics covered during the remainder of this Conference.

I would, however, encourage you to familiarize yourself with this report. In my view, it represents a very scholarly account of the history of the Investment Company Act, and lends some insight into the future direction of investment company industry and the regulation of that industry.

Some of the recommendations in the Division's report have already been considered by the Commission. As a result, the Commission recently put forth two proposals designed to eliminate

the unnecessary regulations that have prevented investment companies from being used on an even broader scale to facilitate investment in our capital markets.

The first proposal is a legislative initiative currently pending in on the Hill. What we are trying to do is make it easier for investors to participate in several types of investment vehicles that are currently feasible because of certain restrictions under the '40 Act. One of these is a new "private" investment company whose shares would be owned exclusively by sophisticated or "qualified" purchasers. The proposal is premised on the theory that sophisticated investors do not need the Act's protection because they are capable of safeguarding their own interests. This theory has worked well in other areas of the federal securities laws, -- for example, permitting private placements of securities to lower the cost of capital for young companies --, and there is no reason that this theory can not be applied with equal success under the '40 Act.

The second proposal is for a new rule to be put in place under the Commission's rule making authority, and hence does not require legislative action. Under the proposed rule, released for public comment last month, asset-backed arrangements, or "structured

financing," would be exempt from the 40 Act under certain conditions. Structured finance is a technique in which issuers pool income-producing assets and issue debt securities backed by those assets. You probably recognize this financing technique as the one that revolutionized the home mortgage market over the last decade. The aim of our proposal is to facilitate the expanded use of structured finance in other sectors of the economy by lessening the SEC's involvement in the process. This is an important point. It is significant that a regulatory agency can have the wisdom to give up active regulation when the markets have shown that they have adequate discipline. The Commission is expected to consider the final rule proposal later in the fall.

I should also mention that the Commission expects to consider soon the proposal from the National Association of Securities Dealers to subject all fund distribution charges, whether a front-end load, deferred-load or an asset-based charge, to a maximum uniform limit. I imagine you heard more about this particular proposal during Joe Hardiman's address this morning.

Other proposals, which you will probably be hearing more about during the Conference, include various recommendations in the area

of corporate governance. Given the growing complexity of fund operations, directors need to be able to focus their attentions on those matters that raise investor protection concerns. Several provisions of the Investment Company Act currently require directors to make detailed, formalistic findings with respect to essentially "routine" investment company operations, such as picking transfer agents in foreign countries. The Division has recommended that these requirements be streamlined or eliminated, so that directors can concentrate on their primary mission: providing effective oversight to insure the highest levels of investor protection.

Additionally, in an effort to strengthen the independence of fund directors, the Division has advanced recommendations with respect to the composition of investment company boards. Currently, at least 40% of an investment company's board must be independent. This would be changed to a majority. The recommended change is intended to recognize the vital role accorded independent directors under the Investment Company Act.

One of the more innovative of the Division's proposals - - and also one that I expect you will be hearing more about in the near future - - involves the creation of two new types of open-end



**investment companies: the "interval" fund and the "extended payment" fund.**

**These new investment companies would differ from the standard mutual fund in that they would not be required to repurchase, or redeem, their shares on a daily basis. Without disadvantaging investors, allowing funds to periodically redeem their shares -- for example, on a monthly or quarterly basis, with a suitable pre-notice period -- would result in more opportunities for investments in less liquid securities, including those of companies with thinly traded shares and those traded overseas. The popularity of these types of funds remains to be seen. But in a free market, these options should be available, especially if they will benefit investors. To the Division's credit, this proposal gives due recognition to the growing interest of investors to participate in the global marketplace.**

**Another innovative proposal involves the creation of a new type of fund that would charge a single or unified fee. The fund would be called a UFIC (u-fick), for unified fee investment company.**

**As an alternative to the current approach where funds may have a variety of fees for different services, the UFIC would have only one,**

fixed fee set by the investment manager. There would be no sales charges or redemption fees. The UFIC's fee would be prominently disclosed on the cover page of the prospectus and in all advertisements. This would enable investors to more readily appreciate the cost associated with their investment, and to "comparison shop" among different funds.

In the area of how investment companies sell, or distribute, their shares, the Division has recommended the repeal of the requirement in section 22(d) of the Investment Company Act that investment companies sell their shares at the price described in the fund's prospectus. The effect of this provision is essentially to fix the price at which a fund's shares may be sold. Repeal of this so-called "retail price maintenance" provision is designed to promote competition by allowing sales commissions to be discounted, which the Division believes will lower distribution prices for investors.

**This proposal has generated more controversy than the Division's other recommendations. I look forward to continued debate on this subject, and expect that comments from the industry, investors, and other interested parties will be carefully considered by the Commission.**

**In the area of fund sales and advertising, the Division has proposed that investment companies be permitted to sell their securities through an "off the page" advertising prospectus - - meaning that investors could elect to purchase fund shares by completing and mailing in a coupon included with the advertisement. Currently, "no-load" funds that use direct marketing techniques, such as printed advertisements, must first send investors a copy of the fund's prospectus before a sale can be made. This frustrates investors who cannot invest during the period between the initial request for the prospectus and its delivery to the investor.**

**This "prior" prospectus delivery requirement does not apply to sales made on the basis of oral communications, such as through broker-dealers. By permitting "off-the-page" advertising, the Division's proposal would offer purchasers of direct-sold funds the same advantages currently enjoyed by purchasers of broker-sold funds, or**

for that matter, any person in this room, who can pick up the phone and call a broker to purchase stock without ever seeing a prospectus.

As part of this proposal, the Division has recommended a number of requirements to protect investors. For one thing, "off-the-page" advertising would be considered a prospectus, and would have to include sufficient and reliable information so that investors could make informed investment decisions. As prospectuses, the advertisements would also be subject to section 12 of the Securities Act of 1933, which imposes liability for false or misleading statements of material fact when offering or selling securities.

I look forward to the Commission's consideration of this proposal, as well as the other recommendations I have reviewed with you today.

In closing, I also look forward to continued participation from the industry -- both in the creation of new products and marketing alternatives, -- and, just as important, in safeguarding the interests of fund investors. At the SEC, we will continue to work hard to insure a bright future for the industry, and we expect that you, as industry participants, will continue your fine efforts that has kept the industry

remarkably safe. The combination of industry self-discipline and SEC oversight has worked well over the past 50 years. This partnership between industry and regulators is necessary for continued success in protecting investors and taking the investment company industry to even greater heights. Thank you.