REMARKS OF

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MUTUAL FUNDS -- AMERICA'S PIGGY BANK NOW AND ... FOREVER?

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

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If, as the old adage goes, cash is king, then investment companies are certainly building quite a kingdom. In 1992, investors poured a record $197 billion into long-term stock and bond mutual funds, an increase of 65% over the previous record of $119 billion set in 1991. And even more impressively, over the past four years, over $400 billion was invested in these same types of mutual funds.

I believe that the opportunities for investment companies' continued good fortune and prosperity are directly linked to the industry's ability to validate the tremendous vote of confidence it has received from the investing public. But as you contemplate the burdens of success, which we will talk about in a moment, I would first like to ask you to consider how you can do your industry and your country a tremendous service.

I believe that the foundation is currently being laid for a future crisis of immense proportions, a crisis larger than the run-away federal deficit now presents. And investment companies have a central role to play in addressing this crisis. As companies move to defined-contribution pension plans, millions of individuals are now responsible for the investment decisions that will determine how well, or how poorly, they will live when they retire. Regrettably, many employees are picking investments destined to woefully underfund their retirement needs. Worse yet, many are not participating at all in these <u>voluntary</u> retirement plans.

In fact, looking at participation rates, and how the assets of defined-contribution plans are currently invested, you start to wonder if, for the next generation of Americans, the sequel to the movie "On Golden Pond," might well be called "On Shallow Pond."

What's at stake here? Well lately, it seems all the talk in Washington concerns the federal deficit. But I believe that the public's rising concern over the deficit has become a proxy for an even greater fear -- a fear that our standard of living is declining, perhaps permanently. For many, the traditional path to the American Dream -- working hard, earning, and saving -- a path taken by our parents and their parents before them, no longer seems enough.

I submit to you that how Americans invest with their defined-contribution plans will have a much greater impact on their future standard of living than the federal deficit ever will. If you simply take all that we know about retirement planning and extrapolate future retiree income based on current investment patterns, you quickly realize that many workers will not be able to afford a comfortable retirement. And with or without the deficit, if defined-contribution assets continue to be invested as they are now, a declining standard of living for millions of Americans will not be a fear, but a self-fulfilling prophecy.

Most employees know how to save for retirement, but now they must be taught how to invest for it. They need help to effectively plan and <u>invest</u> to meet the growing financial demands that retirement now entails.

Recently, the mutual fund industry has become a much larger player in the defined-contribution market. But with this new opportunity comes also new responsibilities. The story of the next decade need not be written as a time when the reservoir of America's retirement savings was depleted by wasted opportunities and poor investment decisions. Instead, if the marketplace -- particularly those that provide the investment vehicles -- take up the responsibility to provide individuals the information and the education they need to plan their retirement suitably, a leisurely and financially secure retirement will still be within the grasp of all working Americans.

<u>THE GROWTH OF DEFINED CONTRIBUTION PLANS</u>

No doubt, defined-contribution plans <u>are</u> the wave of the future. Take a look at these numbers. (See chart attached as Appendix 1) Since 1984, the number of defined-contribution plans grew by over 110%, while the number of defined-benefit plans increased only slightly. According to statistics provided by the Employee Benefit Research Institute, as little as 10 years ago, there were only 12 million American workers participating in defined-contribution plans. Today, there are in excess of 40 million employees using them.

Perhaps even more significant is the short-term trend. In the past four years, the number of defined-contribution plans doubled, but there was almost no growth in the number of defined-benefit plans.

Defined-contribution plans offer both employees and employers tremendous advantages. For employees, the portability of these plans fits the changing demographics of today's workforce. Gone are the days when the average American worker could expect to start and finish his career with the same paternalistic employer. Today, the average employee is expected to hold four to six jobs during the course of his career. Moreover, because the employee bears the entire investment risk of his retirement portfolio, any excessive returns generated go to his pocket. And we all know there is no such thing as an overfunded individual retirement plan.

On the corporate side, defined-contribution plans remove many of the headaches and many of the liabilities associated with funding a long-term retirement plan. They also allow companies to be more realistic when providing benefits in today's challenging economy.

These potential gains will be meaningless, however, if at the end of their last workday, employees cannot afford to retire. Unfortunately, when facing what likely will be the single most important financial decision of their lives, many employees are ill-equipped to take on the new responsibilities of these plans. Indeed, according to a survey done by Fidelity, the most common reaction of employees examining their plans is <u>confusion</u>.

Let's face it, without guidance, the fundamentals of retirement planning escape most employees. Determining realistic retirement goals, selecting an investment portfolio designed to achieve those goals, and continuously assessing the portfolio's performance in a changing investment environment is well beyond the expertise of most American workers.

EMPLOYEE INVESTMENT DECISIONS

This is best illustrated by comparing asset allocation strategies used by defined-benefit plans to those used in defined-contribution plans.

Let's first examine the strategies employed by professionals who manage the 1,000 largest corporate pension funds. (See chart attached as Appendix 2) As you can see, on average over the past three years, they maintained about 45 percent of their assets in equities, about 35% in fixed income securities, and around 3 percent in guaranteed investment contracts offered by insurance companies and banks, better known as GICs and BICs. Though about 15% of all portfolio assets were in cash and other investments, clearly the focus is on equities and bonds.

Now let's examine how employees invest. (See chart attached as Appendix 3) In marked contrast to the professionals, the investment vehicles preferred by employees are GICs and BICs, in which they place almost 35 percent of their funds. Almost one-quarter of the portfolio is invested in their employer's stock, usually with some sort of matching incentive. Less than 18% of their assets consist of other equities. You also see that fixed income securities represent a just over 11% of the portfolio. Note, these charts are cumulative totals for the 1,000 largest plans. But studies also show that many employees place almost none of their plan assets in equities.

Of course, equities will not always outperform the other alternatives in the manner they have since 1982. But just think how much money was left on the table during the last decade when individuals had such a small exposure to equities. And while professional fiduciaries continue to actively re-allocate among asset classes, the same certainly can not be said for most individuals.

To be fair, for some employees, a portfolio dominated by GICs or BICs may indeed be the right investment. But I suspect that most employees choose among investment alternatives without any in-depth retirement planning: they simply pick what looks the safest, with little thought to the ultimate goals that they are trying to achieve.

Whether through a lack of education, insufficient communication, inadequate services, or just plain inertia, Americans are losing the opportunity to provide for their own future standard of living. And this lost opportunity could prove even more costly considering the fact that many companies are now reducing or eliminating their retiree health benefits that were considered sacrosanct just a few years ago.

Add to that the recent talk in Washington of taxing Social Security benefits, of taxing pension benefits and of taxing health benefits -- for those lucky enough to still have them -- and you see why the Wall Street Journal recently stated in this front page article that " ... benefit cutbacks mean a new era of uncertainty for retirees who [once] thought one of life's biggest worries was behind them."

How did we get to this point? How is it that we have the best investment expertise in the world, but have managed to divorce that expertise from the individuals that so desperately need it? Once again the litigious nature of our country is partly to blame. Many employers and plan sponsors see the need to improve communications and provide employees with the information and education that they need. Many, however, appear to be hesitant to voluntarily take on these efforts. Why? Fear of incurring the legal liability for poor investment decisions made by their employees.

Ironically, for employers and plan sponsors, the inaction caused by this fear of litigation may eventually mean more litigation. If employees continue to make poor decisions and wind up with inadequate retirement assets, it will not be too long before class-action lawyers start laying the blame at the foot of every person who possibly could have taken steps to save these employees from themselves.

THE GOVERNMENT RESPONSE:
<u>MORE DISCLOSURE AND ATTEMPTS TO LIMIT LIABILITY</u>

The Department of Labor and the SEC, two of the federal regulators with an interest in this area, are taking steps to address some of the concerns I've just outlined. At the SEC, we have approached this problem from the viewpoint of the plan participant, who, like any other individual purchasing investments, is entitled to the full protection and disclosures that federal securities laws are designed to afford.

But for the many employees participating in defined-contribution plans, this protection is meaningless. The investment vehicles offered by banks and insurance companies are generally exempt from most provisions of the federal securities laws. And no one -- including those entities regulated by the SEC -- <u>is required</u> to provide any information directly to plan participants. Simply put, individuals investing through defined-contribution plans are not entitled to the same information as any other investor making purchases in the open-market.

The SEC's Division of Investment Management ("the Division") recognized some of these deficiencies in its recently released study titled *Protecting Investors: A Half Century of Investment Company Regulation*. To address these concerns, the report recommended that the Commission propose legislation to amend the securities laws in several respects. The suggested amendments would require banks and insurance companies to register the interests in the investment vehicles they offer in connection with defined-contribution plans. The amendments also would require delivery of current prospectuses and shareholder reports to plan participants who select these investment alternatives. Additionally, the Division recommended that the Commission amend the rules under the '40 Act to require mutual funds to deliver shareholder reports directly to plan participants.

The Department of Labor has chosen a slightly different tack. Last October, after a five-year process, Labor adopted Regulation 404c-1, a new regulation under ERISA. This new rule is designed to encourage plan sponsors to provide more information to participants by directly addressing the liability concerns of employers. Compliance is not mandatory, but if the rule's requirements are met, defined-contribution plan sponsors will supposedly enjoy relative immunity from lawsuits if employee investments don't live up to expectations.

Labor's regulations and the Division's recommendations are steps in the right direction. However, some problems remain. Although many employers hope to comply with Labor's new regulations, I am not sure that they will be able to avoid future