

The Future of Regulated Funds: Modernizing the '40 Act

Eric J. Pan
President and CEO
Investment Company Institute

Investment Management Conference
Palm Desert, California

Monday, March 28, 2022

Introduction

I'm sure you noticed that we've renamed this conference. What used to be called the "Mutual Funds and Investment Management Conference" is now simply the "Investment Management Conference."

This change reflects a simple reality. While mutual funds still comprise the bulk of our membership, we want to speak to everyone present, including ETFs.

The conference has not only been renamed but also re-examined to find ways to be more informative and useful to you.

The name change further reflects our own efforts at the ICI to be a more effective advocate, resource, and voice for the industry.

By now, I'm sure you've all heard that the ICI recently completed a strategic review. At its core, the review's recommendations will guide how the ICI carries out its mission for the next 8–10 years, and it will be good for our industry as we work for the ultimate benefit of long-term individual investors.

We see a chance to double down on lifting up individual investors. The success of our industry depends on the value we create for them. So we want to help you create more value, for more people, at more stages of life, using more products and tools.

Mutual funds and ETFs remain critical to achieving that end, and ICI will continue to give fund providers the strongest support. But we also recognize that our members are broadening the scope of their business activities beyond mutual funds and ETFs, and that means we need to broaden our remit, as well.

While vigorously advocating for '40 Act funds will always be our main focus – it is foundational to us – it is necessary to develop expertise and knowledge in other products, such as defined contribution plan CITs and retail SMAs. Broadening our remit will enable the ICI to more effectively help our members in the legal, policy, and operational challenges that lay ahead, as our markets continue to evolve and attract new investors.

The bottom line is this: as we broaden our remit, we will broaden the impact this industry will make on society. And as we prepare to implement our strategic review, I want you to know that ICI's commitment to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor is stronger than ever. And I know the same is true for you.

The Miracle of Mutual Funds

The strategic review will help us strengthen the foundations of our industry, which are '40 Act products. I recognize that discussing these products may seem odd, given that I just announced our expanded remit to include other investment products. Yet in my view, it's impossible to *over-emphasize* the importance of '40 Act products, especially mutual funds, and the difference they make in our economy and society.

Mutual funds, along with ETFs, are the *engine* of middle-class financial security. At this exact moment, more than 62 million American households are invested in these products. All told, families have invested a staggering \$27 trillion in mutual funds, which is more than America's annual GDP. And they're investing with a clear purpose. More than 90 percent of mutual fund holders are saving for retirement. Huge percentages of people are preparing for an emergency, their children's education, or a large life purchase, like a home.

Surveys show that nearly 9-in-10 mutual fund-owning households are confident their investment goals are on track. You'd have to look far and wide to find *anything* in modern America with such high approval ratings. And we all know why.

Mutual funds offer incredible diversity, and today, there are more than 12,000 regulated investment funds available for purchase. They run the gamut of investment strategies, and at least 740 are based on ESG criteria, which increasingly matters, especially to younger investors. The average fund holds shares in 227 companies, which is far more than most investors would ever purchase on their own.

Ninety-five percent of investors say diversification matters. And the exact same percentage say mutual funds are worth the cost. That's impressive in normal times. It's *incredible* at a time of soaring inflation and low economic confidence.

Obviously, I'm preaching to the choir. Mutual funds and ETFs have helped more Americans save and prosper than any other investment product in history. The pandemic did not diminish that reality. In fact, it made people more attuned to the importance of long-term financial planning. I believe the past few years made our fellow Americans more appreciative of mutual funds and ETFs.

Much credit goes to you, and to your dedication and commitment to your work in supporting the regulated funds industry for the ultimate benefit of the individual investor. You are key to the success of our industry, and I want to thank you for what you did over the last two years – and what you will continue to do in the years ahead.

Modernizing the '40 Act

We at the Investment Company Institute tell the story of regulated funds to legislators and regulators, day-in and day-out. But we don't just tell them what you do. We also tell them you can do so much *more*. With the right policy framework in place, mutual funds and ETFs can magnify their impact, and the number of investors they serve.

Ensuring and improving that policy framework is one of ICI's top priorities. It has been that way since the passage of the '40 Act, and 82 years later, we're as committed to that landmark law as ever. It has proven its worth and stood the test of time. And yet, after so many years and so much change, we also recognize that in many respects, the '40 Act regulatory framework must be adapted to the times.

In that spirit, I'm pleased to announce that the ICI is launching a comprehensive effort to *Modernize the '40 Act*.

It will be one of the most significant initiatives of the ICI in recent years, and our goal is simple: we want to work with the SEC to make sure that the '40 Act regulatory framework provides the flexibility and stability that modern times demand. Most of all, we want to ensure that investors' interests are being served. That's what the '40 Act has always aimed at; we aim to make it even more of a reality in the 21st Century.

This is not our first campaign to modernize the '40 Act. We have consistently sought to work in a positive and helpful way with the SEC and Congress since the law was passed, and our collaboration has kept this regulatory framework relevant, time and again.

I think of the 1970s, and the introduction of money market funds.

I think of the 1980s, and the expansion of distribution financing arrangements including the adoption of Rule 12b-1.

And I especially think of the SEC staff's work on the Protecting Investors Report of 1992 and the industry's contributions to that effort. The "Red Book" recommendations paved the way for rule changes that enhanced the independence and effectiveness of fund directors and facilitated the development of interval funds.

There are so many examples of the ICI working with the SEC to faithfully apply the '40 Act, including many more recent examples. Yet the "Red Book" is worth dwelling on, briefly.

In the cover letter, the SEC's then-chairman, Richard Breeden, wrote, and I quote, "overly broad regulation can limit the choices of investors, and unnecessary regulatory costs are ultimately passed through to investors." Breeden continued by promising to identify areas where, quote, "the law should be more flexible, or where regulatory costs could be reduced, without sacrificing the quality of investor protection." He concluded by saying, "after a half century of market change, it is appropriate to consider where we can update and improve the overall system."

My friends, what was true then is true now. And just as we helped the SEC modernize the '40 Act then, ICI will help modernize it now.

To be sure, the law does not need a radical revision. We simply want to work with the SEC to use its existing authority to better apply the law. The SEC has a chance to *clear* up the confusion that bogs down '40 Act regulations and *clean* out the complexity and costliness that has crept into federal rules. The '40 Act's regulatory superstructure must be simplified, for the sake of long-term individual investors.

We all know that '40 Act regulations require a delicate balance. If they are too prescriptive, they harm the flexibility that funds need to serve investors, strengthen capital markets, and grow the economy. Similarly, if regulations are too numerous, then compliance becomes unaffordable, leading to higher costs for investors and less viability for small and mid-size fund providers.

It is important that we spend the time to consider how the '40 Act can be made even better in protecting and promoting the interests of individual investors, in line with the law that gave rise to our industry. At the end of the day, *modernizing* the '40 Act is really about *preserving* the '40 Act – that is something I believe all Americans – the industry, the regulators, and the investors should support.

ICI's board of governors is very enthusiastic about this project. With their support, the ICI staff is moving forward in planning this study, and we are looking to undertake this project over the next two years as we happen to approach the 100th anniversary of the first modern mutual fund.

Here's what you can expect.

To start, we will undertake a comprehensive study of the '40 Act and all associated regulations, to identify what's working and what may not be working so well. We will also look at related policy issues, such as tax treatment of regulated funds, where there is much room for improvement for the benefit of individual investors.

At the same time, we will take stock of the current state of the industry, including how it has changed in recent decades, and how it is expected to change in the years to come. We will look at what today's investors expect, shifts within capital markets, and the transformative effects and potential of technology.

We then want to think about how we can strengthen the '40 Act with an eye toward making it more efficient, more appropriate for the current time, and better for investors. We want to develop ideas and recommendations which we can then submit for consideration by policymakers and explain our analysis. Our goal will be to expand access to investment products, leverage technology to a greater extent, and – above all – empower investors to access the mutual funds they want at a price they can afford.

Throughout this process, we'll tap the best expertise. That includes the best legal and financial minds who know the '40 Act backwards and forward, and we'll seek the input of a range of stakeholders to vet, debate, and develop ideas. The process will be thorough *and* transparent, and crucially, you will be able to participate. In fact, your involvement is critical to the success of this endeavor.

In the final stage, we will develop policy proposals and seek to present them to the SEC and the broader policymaking community. That could mean letters to the SEC on technical recommendations; deeper reports on more complicated topics; and a series of public events to highlight key policies, among other ideas.

We already have a sense of many areas in which we will explore for ideas that will benefit long-term individual investors.

For instance, we want to explore ways to enhance the effectiveness and efficiency of board oversight, on behalf of shareholders. We've heard this suggestion from both the [ICI Board](#) and from the IDC Governing Council.

Another opportunity involves disclosure. Investors need information they can easily understand and quickly access.

Speaking of investments, we plan to consider ways to give retail investors greater access to alternative and less liquid assets through registered funds. In so doing, we would seek to facilitate diverse investment strategies and fund structures to address different investor needs.

The final bucket I'll mention is the weight of accumulated regulation. Broadly speaking, we need to look critically at rules under the '40 Act, both individually and in relation to one another. This is key to ensuring that the overarching regulatory framework protects the interests of investors and allow fund managers to meet investors' needs in today's dynamic and ever-changing financial markets.

Please join the Investment Company Institute in this important effort. With your support, we will help millions of American families and ensure the US capital markets continue to be the envy of the world.

Some reforms will require working with Congress and the White House. Ideas like limiting hedge fund investment in closed-end funds

can't be done without legislation. The same is true for rollup tax treatment for funds. ICI is determined to partner with lawmakers, on both sides of the aisle, to move the ball forward.

Yet the bulk of this work must be done in partnership with the SEC. Whether it's e-delivery of communications, in-person meeting relief, affiliated transactions, or one of a thousand other things, the SEC has the authority to apply the '40 Act's timeless principles to the needs of our time.

We intend to appeal to the Commission's duty to its guiding mission, which is to make markets more efficient and effective for individual investors. Everything we're doing, and everything we're recommending, is to serve investor interests and secure their long-term financial future.

Conclusion

As we prepare to begin this new comprehensive review, we also want to tell the nation the mutual fund and ETF story.

We want to reach out to investors across America, reminding them how much you matter to their financial futures. We want to communicate to policymakers, reminding them that your success is America's success. By sharing the story of mutual funds and ETFs far and wide, we can inspire a new and younger cohort of investors and spark the new and better policies that will make long-term investing even more accessible and affordable.

That's what this is all about – meeting the needs of *current* and *future* investors. Mutual funds, and more recently ETFs, have long been the foundation of American financial planning, and they are only growing more important. We have an opportunity – and I believe an obligation – to extend their benefits to the next generation. And we will make the most of it.

Thank you for joining the ICI in this critical work. And thank you for what you do for America, every single day.

Enjoy the conference!