



**REMARKS OF**  
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**U.S. SECURITIES AND EXCHANGE COMMISSION**

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

**1993 MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE**  
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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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MUTUAL FUNDS: AMERICA'S PIGGY BANK  
NOW AND ... FOREVER?

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 voluntary 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 invest 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.

#### THE GROWTH OF DEFINED CONTRIBUTION PLANS

No doubt, defined-contribution plans are 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 confusion.

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:  
MORE DISCLOSURE AND ATTEMPTS TO LIMIT LIABILITY

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 -- is required 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

lawsuits. Twenty to thirty years from now, if millions of retirees are having trouble making ends meet, you can bet that plaintiffs' lawyers across the country will be looking for someone to sue. The new regulations might ultimately provide an adequate defense, but this may be an instance where tomorrow's lawsuits can best be avoided by taking steps today to help employees build sufficient retirement assets. That would be a better ending, wouldn't it?

As for the Division's recommendations, I personally see them more as a means of last resort. Certainly, if all else fails, requiring that prospectuses be delivered directly to plan participants will increase the information available to them. This assumes, of course, that the logistical problems -- such as identifying individual employees and obtaining employer permission to contact them -- can be resolved. But frankly, most investors do not spend a great deal of time reading bulky prospectuses when they are filled with legalese. Moreover, many employees lack the basic knowledge needed to make the prospectuses a useful tool for retirement planning.

So rather than paper employees to death -- and burden everyone with more printing costs -- I would rather see a marketplace solution. Indeed, as the competition to manage defined-contribution assets has become more heated, those providing the investment vehicles have creatively been offering more services. I am pleased to see that some mutual funds are voluntarily providing short form versions of their retail prospectuses directly to plan participants. But even more important, I am hopeful that by providing more user-friendly, understandable disclosures the marketplace can convince regulators that sending out literally millions of prospectuses prior to the purchase of any products is not an example of cost-effective regulation.

As an aside, these same types of concerns also underlie my views concerning the proposal for off-the-page purchases of mutual funds. Some have criticized off-the-page purchases as lessening the protection available to investors, possibly leading to impulse purchases by those mesmerized by slick ads.

Of course, the ads would not provide the quantity of information contained in a long prospectus. But the ads would have the distinct advantage of delivering the most vital information in one easy-to-read format. Longer prospectuses are great for investors who read them, but the fact is, many people do not. For these individuals, a shorter prospectus, including those in the form of a printed ad, conveys the most essential disclosures at the very time they make their investment decision. Seen in this context, this proposal, if enacted, could actually provide more practical protection by encouraging investors to read a prospectus, albeit a shortened one.

Like potential off-the-page purchasers, however, employees do deserve the most efficient means to obtain the needed information to make an effective investment decision. But the disclosure issue is just one part of the problem: which leads me to my main concern. The most pressing difficulty facing employees is that most lack the education and experience, and in some instances, the investment options, to plan their retirement effectively. And while providing better and more understandable disclosures will help, employees must be taught to use what they are given. The real solution is for the market players in this area -- the employers, the plan sponsors and those that provide the investment vehicles -- to step up to the plate and provide the education and investment alternatives that are needed.

Plan participants must be taught the fundamentals of investing, including, among other things, goal-setting techniques, asset allocation principles, the theories of risk and reward, and how to read a prospectus. They must be taught that retirement planning is a long-term endeavor. And they must be taught how to avoid the classic pitfalls of inexperienced investors, such as chasing last quarter's hot sector fund rather than dollar-cost averaging into an asset class.

We all know the Chinese proverb, "Give a man a fish and he eats for a day, but teach him how to fish and he eats for a lifetime." By educating Americans how to invest wisely now, you will be helping them to achieve a lifetime of security and prosperity.

#### EDUCATING NEW CUSTOMERS

Now, it is not mere coincidence that the education effort needed to help participants in defined-contribution plans is almost identical to the education effort that many are calling for the mutual fund industry to direct towards the public at large.

With defined-contribution plans, employees can no longer be satisfied by simply saving for their retirement -- they must also be investing for it. But for millions of other Americans now purchasing mutual funds, the line between saving and investing is becoming increasingly blurred.

In a sense, mutual funds are rapidly becoming America's piggy bank. By participating in one family of funds, the average household can fulfill most of its financial needs. Americans are now depending on mutual funds to provide their checking accounts and credit cards, to protect and grow their savings, to pay for their kid's college tuition, and to provide for an adequate standard of living at retirement.



The majority of the new customers now entering the business represent a new breed of consumer. And as of late, with interest rates at 15-year lows, many individuals are now turning to mutual funds, particularly bond funds, as an investment vehicle to increase current yields. In fact, just two weeks ago, an activity report prepared by the Securities Industry Association noted that for the first time, bond fund assets now exceed those held by money market funds.

But I share the concerns voiced by many that this new breed of investors may not fully understand the nature of the investment they are buying in record amounts. For the mutual fund industry, there may be no greater challenge than to educate the flood of new first-time investors about what to expect from their investments. Indeed, these new customers will ultimately determine whether the mutual fund industry can build upon its recent successes. A few bad experiences for these new customers, for whatever reason, will severely limit the potential for further growth in the industry.

I do remember darker days for the mutual fund industry. I do remember that this has been a cyclical industry. In 1978, when I first started on Wall Street, I had the privilege of spending many evenings with a man that I know many of you fondly recall: Kirk Bride Miller, who at that time was Chairman of T. Rowe Price. We were co-chairman of a civic project, and we spent many evenings together at his house. I have two distinct memories from those evenings. First, I remember when he would stick his head out the door to call his cats: "Here POLAROID ... Here XEROX ..." And second, I remember his many stories of the dark days of the mutual fund industry in the mid-seventies.

Today, the mutual fund industry is becoming increasingly confusing. It seems everyday new funds are launched and fund families get new members. The confusion is bound to grow with the advent of multiple classes of shares and Hub and Spoke structures. But the advantages these arrangements provide -- easier access to international clients, greater flexibility, and reduced regulatory costs, just to name a few -- will be lost if new customers refuse to invest because they can't understand what they are buying. Similarly, the recent press attention on fees may possibly turn off customers unable to appreciate what they get in return for paying these costs.

In the midst of this environment, I'm certain many of you are wondering exactly what the SEC hopes to add by introducing interval funds to the mix. In one word, the answer is liquidity. By freeing portfolio managers from the shackles imposed by daily redemptions, I hope liquidity can be increased in certain sections of our capital markets. Moreover, investors can possibly achieve better returns by gaining greater access to

small cap securities that are thinly-traded or perhaps trade in smaller overseas markets. Of course, I am sympathetic to the concerns that a change to the fundamental nature of redemption rights should be carefully considered at a time when the industry is awash with new investors. But if interval funds improve our capital markets and have the potential to increase returns for investors, we should give them a chance to succeed before deeming them too complex for public consumption.

With or without interval funds, education is the surest way for the industry to eliminate potential problems down the road. These educational efforts will be for naught, however, if non-market risks -- such as those from poor management, neglect or even intentional misconduct -- are not minimized.

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 services industry. In fact, starting in the 1930's, when investment companies came to the government asking to be regulated, our public/private partnership has been a virtual paragon of government regulation.

But as more and more individuals entrust their savings and investments to mutual funds, the industry will be subjected to even greater scrutiny from investors, regulators, and the press. To the industry's credit, there have been relatively few enforcement cases against mutual funds and their directors. However, I was particularly disturbed by the recent administrative proceeding the Commission instituted against the investment advisor and portfolio manager for a tax exempt money market fund. For those of you unfamiliar with the proceeding, our action was based on the fund's purchase of over \$175 million of unrated securities, which included \$96 million of synthetic securities. All of these securities failed to meet the quality standards for investments in tax exempt money market funds, which caused violations of the pricing provisions.

These were serious violations, even though no investors lost money and no directors were accused of any wrongdoing. But the fact that the violations occurred at a money market fund should make us all pause and take note. Short-term money market funds now contain in excess of \$548 billion, and most investors consider their money market funds to be as safe as bank deposits. I hope the message was heard loud and clear that the Commission will closely examine the manner in which directors, investment advisors and portfolio managers perform their duties under Rule 2a-7. Hopefully, our recent proposals to relieve directors of some of their annual review responsibilities will eliminate unnecessary distractions from these and other important tasks.

And certainly, while our Division of Investment Management will continue to pay a great deal of attention to this area, I believe it is in the best interests of the industry as a whole to make every effort to police itself.

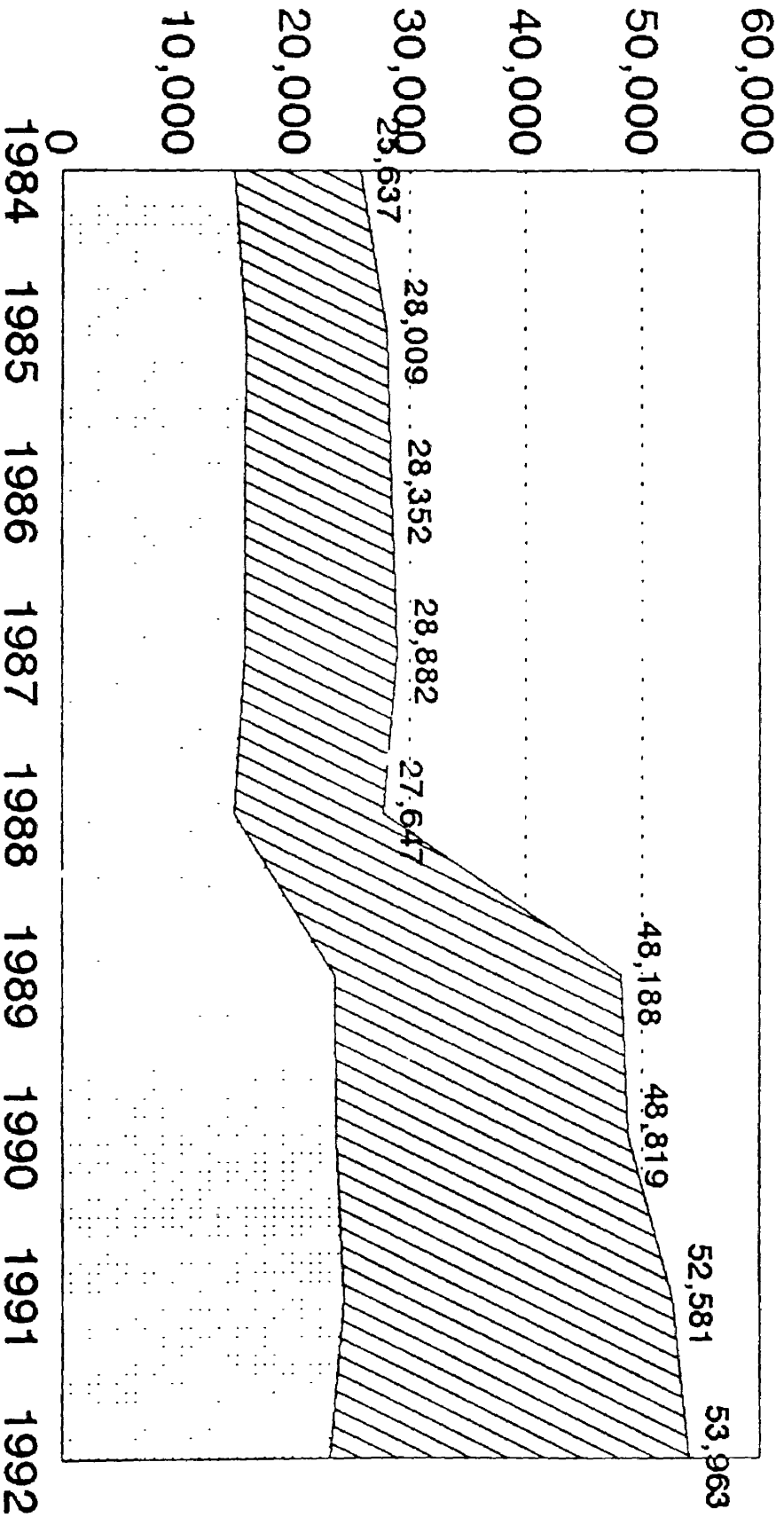
#### CONCLUSION

On the whole, the mutual fund industry has done an excellent job of maintaining the public's trust after a decade of phenomenal growth at a break-neck pace. And the industry has performed a tremendous service for this country and its capital markets by providing the means for millions of Americans to buy stocks and bonds and stand on equal footing with the professional investors who now drive our markets. And since 1990, while the banking community has been enduring a severe credit crunch, mutual funds have acquired over \$120 billion in equity securities, providing essential liquidity to the markets, and vital capital to our economy.

But now the bill is coming due for the success the industry has recently enjoyed. To be paid in full, the industry must undertake to educate the millions of new and potential customers on the horizon. I firmly believe that the more knowledgeable Americans are concerning mutual funds, the more likely they will be to invest through them. And if part of this educational process includes helping the next generation of Americans plan for their retirement, then the future of our country will be as bright as the future of your industry.

Thank-you.

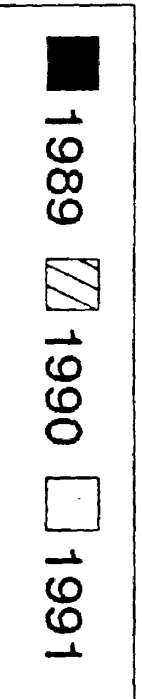
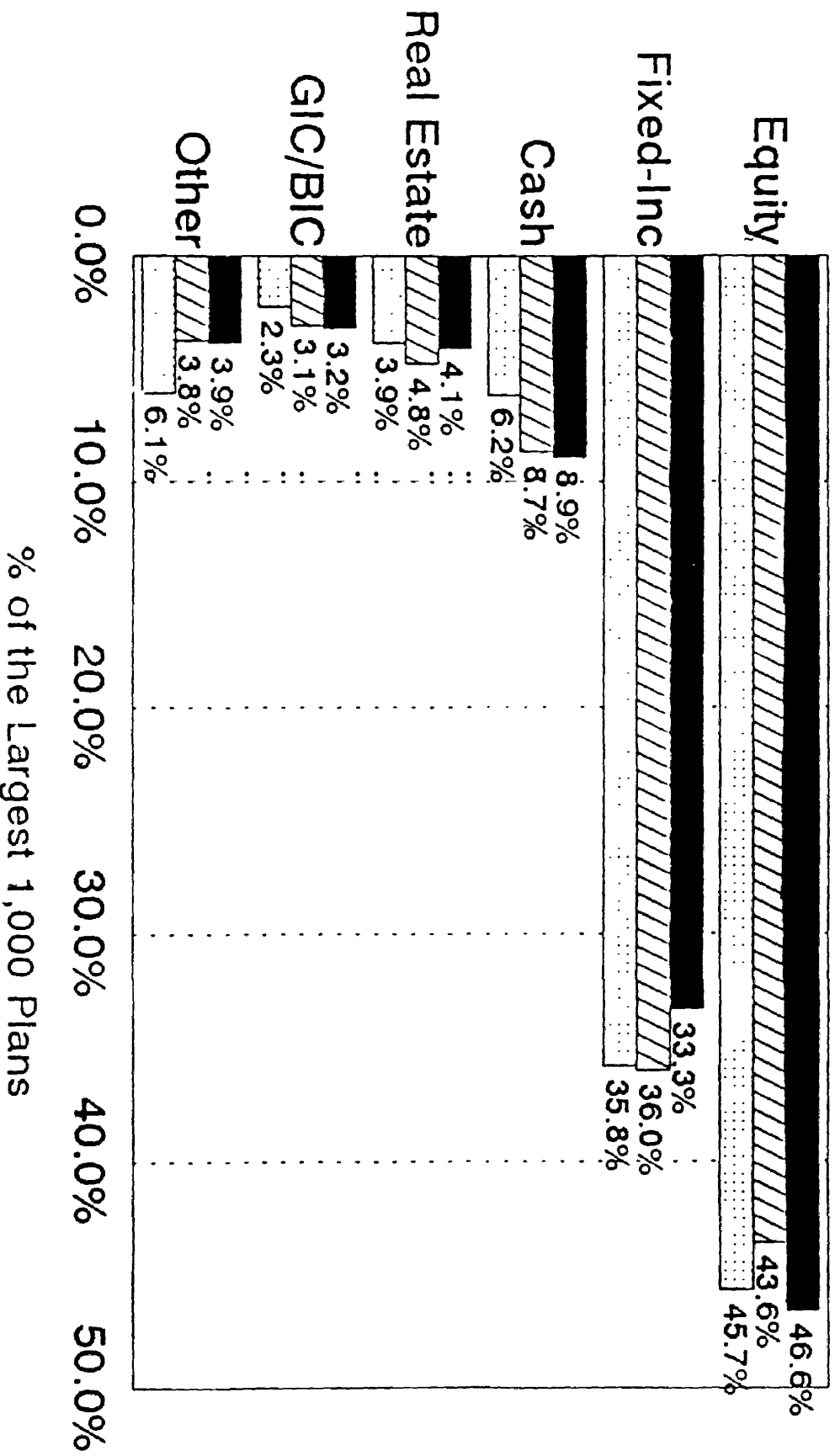
# Number of Private Defined Benefit Plans Compared to Number of Defined Contribution Plans June 1984 - June 1992



Defined Benefit
  Defined Contribution

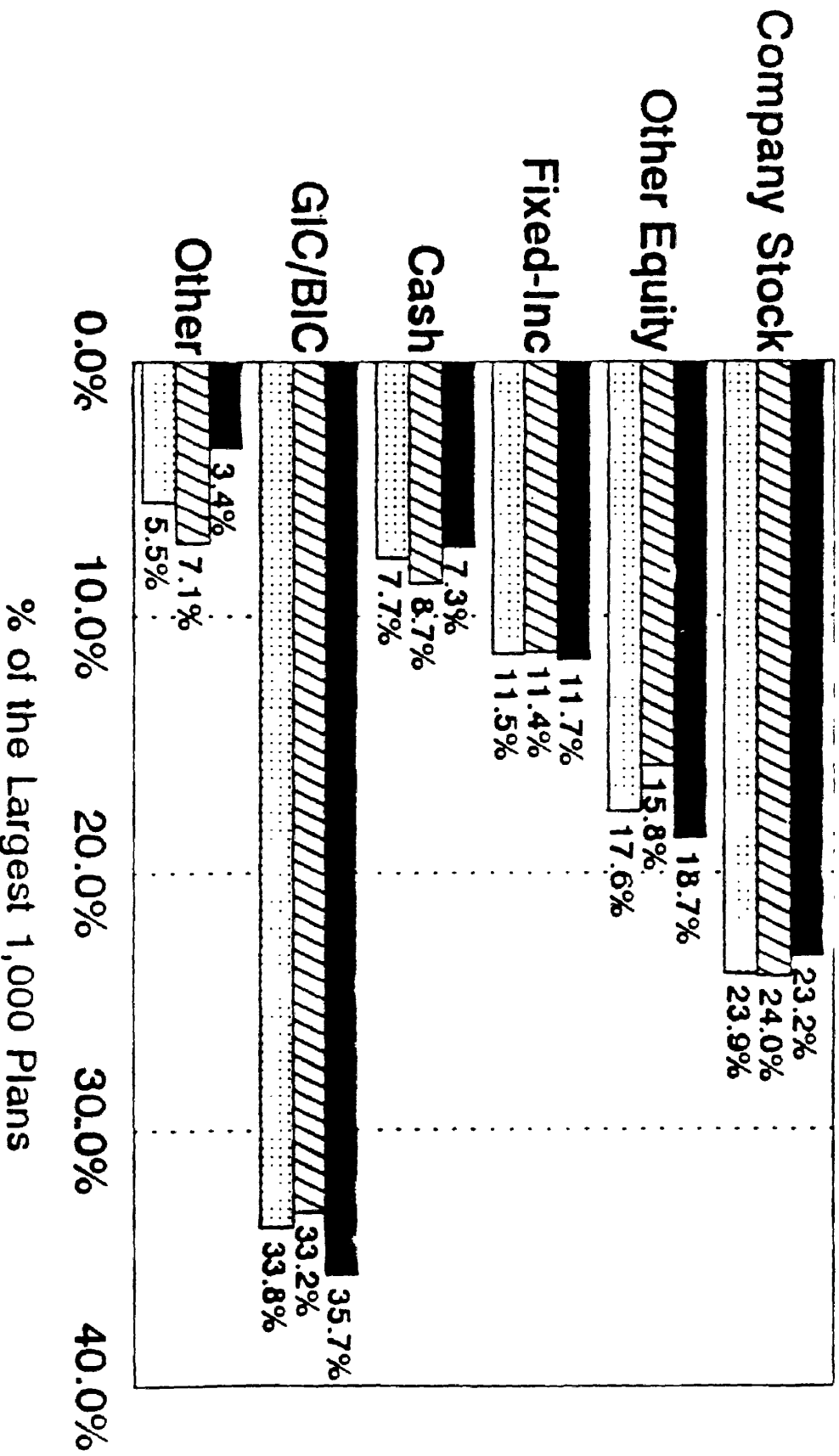
Source: Money Market Directory of Pension Funds and Their Investment Managers  
DC Plans include stock, thrift & savings, money purchase & 401K plans.

# Allocation of Assets in the Largest 1,000 Defined Benefit Pension Plans 1988-1991



Source: Pensions & Investments

## Allocation of Assets in the Largest 1,000 Defined Contribution Pension Plans 1988-1991



Source: Pensions & Investments