

HELPING AMERICA SAVE FOR THE FUTURE

[Editor's note: The Investment Company Institute held its general membership meeting in Washington, DC, on May 20-22, 1996. The meeting, attended by more than 1,800 mutual fund executives, service providers, regulators, the financial news media, and others, focused on the theme of "Helping America Save for the Future." A number of distinguished speakers addressed the issue of retirement savings to the mutual fund industry. The Institute is pleased to publish excerpts of remarks presented at the meeting by Senator J. Robert Kerrey (D-NE), Institute Chairman Jon S. Fossel, and Institute President Matthew P. Fink.]

Keynote Address

The Honorable J. Robert Kerrey U.S. Senator—Nebraska

[Sen. Kerrey was first elected to the U.S. Senate by the state of Nebraska in 1988, and was reelected in 1994. Sen. Kerrey has become a nationally recognized advocate of saving for retirement, reform of entitlement programs, educational technology, fiscal responsibility, and health care reform. Prior to his election to the Senate, he served a term as Governor of the state of Nebraska. In that capacity, he took on the state's budget with a 3 percent deficit and was able to balance it in each of his four years in office, as well as turn in a 7 percent surplus. Sen. Kerrey earned a Congressional Medal of Honor while serving in Vietnam. He is a graduate of the University of Nebraska at Lincoln.]

As chairman of the Bipartisan Commission on Entitlement and Tax Reform, established in November 1993 to recommend alternative tax reform proposals and revisions in federal entitlement programs, Sen. Kerrey has promoted government initiatives that would help the nation achieve fiscal responsibility while securing a better future for all Americans. In 1995, he cosponsored "The Personal Investment Plan Act" with Sen. Alan Simpson (R-WY) to enhance the current Social Security system by introducing an element of individual saving. In presenting keynote remarks to the Institute's general membership, Sen. Kerrey stressed that Americans should be given—and are capable of accepting—personal responsibility for their financial futures.]



Perspective is a series of occasional papers published by the Investment Company Institute, the national association of the American investment company industry. Paul Schott Stevens, executive editor; Sue Duncan, managing editor.

I appreciate the chance to address this group. I was asked and will speak on the subject of retirement. I believe in general terms that a discussion of retirement, and especially the savings needed to provide for that retirement, is connected to some of the most important issues that we face today: middle-class economic insecurity, United States economic growth, international competitiveness, family stability, and the promotion of virtuous behavior. I'd like to talk about the issue of family investments, particularly those, as I said, made for the purpose of providing for retirement.

In order to save for retirement, I must look into the future. I must believe that I will be alive when the future arrives, and I must understand the need to change my behavior now in order to have the future I prefer. This is a very difficult job to do, and what is difficult for the individual is doubly difficult for the nation.

America needs the equivalent of the gift that was presented to Ebenezer Scrooge in A Christmas Carol. You may recall that the Ghost of Christmas Future visited Ebenezer Scrooge and presented to him an image of what the future would be like if he continued in his present behavior. Reacting to this grim view, Ebenezer said, "Are these the shadows of things that will be, or are they the shadows of things that may be only?"

Before I show you what I see and what I believe we should do to help change the future of America, let me lay before you nine beliefs which form the foundation of my proposal.

Wealth, Taxes, and Entitlements: Nine Beliefs

- 1) Wealth is not the same thing as income. A person can have \$1 million a year of income, yet save no money, create no jobs, build no assets, and accumulate no wealth. The prodigal son comes to mind. His best skill was spending someone else's wealth.

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- 2) America is still the wealthiest nation on earth. We are wealthier than we have ever been at any point in our history. We have invested, saved, produced, and created our way to wealth. Anyone who argues that America is either broke or poorer than we were in the '50s or '60s or any other decade is either not telling the truth or hasn't made the effort to examine the truth.
- 3) Since World War II, the federal government has collected in taxes a nearly constant percentage of the nation's gross domestic product. Despite all the changes in the tax code since then, federal taxes have remained an amazingly constant 18 to 20 percent of GDP.
- 4) While the total amount of money withdrawn from the economy has remained constant, the mix of federal government expenditures has changed—and changed dramatically. In 1963, a generation and a half ago, 70 cents of every federal dollar was spent on investment items such as education, infrastructure, technology, and defense, all of which endow our future. Thirty cents was spent on “automatic pilot,” that is, paying for interest and entitlements. In 2002, the tip of our budgetary noses, we will be transferring 72 cents of every dollar for entitlements and interest, and we'll only be spending 28 cents on investments which will help grow our country. Ten years later, as 77 million baby boomers begin to retire, 100 percent of the federal budget will be consumed by entitlements and interest payments unless we have massive tax increases or severe budget benefit cuts. By that time, our federal government will have been converted into an ATM machine, with deposits made by those who are working, and withdrawals made by those who are not.
- 5) Our economy would grow much faster if we scrapped our income tax system and replaced it with a progressive consumption tax which gave individuals and businesses a powerful incentive to save and invest. It matters as much how we collect our taxes as how much we collect.
- 6) Perhaps most difficult of all, anti-poverty entitlement programs such as AFDC, food stamps, and school lunches are not the driving federal budget problem. Eliminate them and we still have unsustainable growth. The real problem is payments that we owe tomorrow, not today, for retirement and health care.

“As 77 million baby boomers begin to retire [in 2012] . . . our federal government will have been converted into an ATM machine, with deposits made by those who are working, and withdrawals made by those who are not.”
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- 7) Social Security and Medicare are not savings programs. The 12.4 percent paid by employees and employers on the first \$62,700 dollars of wages, and the 2.9 percent paid on all wages, does not go into individual savings accounts. Instead, the tax paid by today's workers is used to pay the retirement and hospital benefits for current beneficiaries. The function of the surplus created in 1983 by the Greenspan Commission was to help baby boomers prefund their retirement period. The Commission recognized that confiscatory taxes would be required to pay for their retirement without a reserve, so Congress enacted those changes, and President Reagan signed the bill into law with the belief that stability would be achieved by keeping payroll taxes higher. Currently, 2 percent of payroll is not needed to maintain a pay-as-you-go system. That money has not been saved.
- 8) There is no free lunch. Miracles happen, virgin births are possible, but wealth without work, production, and deferred gratification does not happen. Further, while financial wealth is not as important as the character needed to produce it, a nation that cannot offer the promise of financial wealth to all of its citizens is a nation that will struggle to maintain free enterprise, capitalism, and liberal democracy.
- 9) Our federal laws matter and are needed to promote economic growth in a manner that conforms to other values held by our citizens. An unrestrained market, where we expect the invisible hand to do it all, will disappoint us for moral and economic reasons. For moral reasons, when we watch a CEO add to his or her stock wealth by subtracting income from thousands of workers, we will want to put the law on the side of the workers. For economic reasons, we will want to make collective investments in transportation, education, and research, for example, which no individual or business will make. And by the way, lest you doubt it, when Americans decide they are going to do something—whether it is in cancer research or space exploration—there isn't a nation or other group of people on the planet that can match our collective talents.

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These nine beliefs form the foundation of what follows.

Addressing America's Financial Insecurity

The hottest political issue in American today is this question: why is it that when our economy is growing and strong, people feel vulnerable and insecure about their financial future? Policy leaders have come up with a variety of proposals to address the problem. Democrats in the Senate, for example, have simplified their economic mission to that of providing paycheck security, health care security, and retirement security. Like our Republican colleagues, we have endorsed a specific plan to balance the budget in seven years. We are fighting to increase the minimum wage and provide health care to families who are struggling with the cost of education and training. We are trying to pass bipartisan legislation that will make it easier for Americans who lose their jobs to retain their health insurance, and we have been advancing a package of pension reforms that will make it easier for small businesses to provide pensions and more likely that women will not be left holding an empty bag.

All of these proposals will help. However, I believe a more serious problem which is adding to economic insecurity is that the law governing our two biggest entitlements programs, Social Security and Medicare, contains two very big flaws: 1) the future promise to pay benefits outstrips our ability to fund them due to the unprecedented size of the baby boom generation and the unexpected good news of our living longer; and 2) it encourages us to forget that the best hedge against insecurity is that which I have learned to do for myself, not what I have learned to get others to do for me.

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—Senator J. Robert Kerrey*

The Personal Investment Plan

Today I would like to lay before your group a modest proposal—uncharacteristic for me—to change our federal laws in a way that will empower every American worker in the task of increasing their own security by increasing their own wealth. Be advised that critics, especially those who use their tax-exempt status to spend tens of millions of dollars a year to perpetuate the myth that Social Security is a savings program, like to bait audiences by describing this proposal as a radical change in Social Security, or that it represents a draconian cut, or that it leaves seniors foraging in the alleys for food. It does none of these things.

What I propose is to change our law so that American workers would be given the option of putting two percent of their current payroll tax in a range of higher-yielding investments. Unlike Social Security, they would own this account. It would be a part of their wealth. Also, unlike Social Security, they would be able to tailor the conversion to annuity according to their needs rather than being dependent upon Congress to tell them what they could or couldn't do.

What I and Senator Simpson, that great and, unfortunately, retiring Senator from Wyoming, propose to do is create personal investment plans for every single worker in America today. Please note that I said every single American. This proposal does not affect the size of the checks being sent to every Social Security beneficiary who is currently eligible. So please don't just ask somebody who is 70 years old to answer the question, "What do you think of this proposal?" Instead, ask a family with wage earners who are 48 years of age or younger; ask a family whose median income is plus or minus 30 percent of the national average what they think of a plan which will increase their savings by 2 percent of their income.

The personal investment plan which I have cosponsored with Senator Simpson would allow individuals to contribute 2 percentage points of their current payroll tax to a personal investment plan, such as an IRA-like account or a thrift savings plan that is offered to federal employees and many other employees in the private sector. Unless you expect to inherit wealth, win the lottery, or build the next Microsoft, the only way to really generate wealth is to generate a little bit of savings over a long period of time.

In an era of wage stagnation and diminished take-home pay, it is very hard for most middle-income Americans to accumulate their own wealth. Having individuals invest 2 percent of their payroll tax in investments other than Treasury bonds—such as equities—they can expect a higher return and, therefore, increased wealth. This change in the law will make Social Security an even more powerful and progressive way to provide retirement security, and will make it more relevant to the retirement problems of the future.

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Don't Put Problems Off Until Tomorrow

The private investment plan would also allow workers to experience the benefit of compounding interest rates. Recent studies have determined that, because of longer life spans, individuals on average have to triple their current level of savings in order to retire in comfort—and that assumes no curtailment of Social Security benefits. The longer an individual waits, the harder it will be to acquire the appropriate nest egg. Those politicians who were arguing delay are those who will in the end be held responsible for penalizing Americans who will suffer as a consequence of not beginning now to accumulate the additional savings that they will need in their retirement. And this is due, as you all understand better than I, to the power of compounding.

I'll offer this example: if an individual invested \$500 a year in ten-year Treasury bonds and reinvested the interest, beginning at age 25 in 1956—that's \$20,000 they would have invested since age 25 for a period of about 40 years. That investment would have grown to \$134,883 by the time that person turned age 65 at the end of 1995.

If the same \$20,000 were invested beginning at age 35 in 1966, that individual would have to put aside \$667 a year, and he or she would only have \$91,000 at the end of 1995.

In ten more years—waiting until you're age 45 in 1976—the individual would have to put aside \$1,000 a year, but only have \$54,343 to show for it.

Do as many of us do and put off until tomorrow (and, not only that, we have children whose education we have to pay for)—wait until you're age 55 to start saving—and you have to put aside \$2,000 a year, but would only have \$30,141 to show for it.

The purpose of presenting to you something that you already know is that most Americans don't know this fact. Most Americans believe that time is on their side when it comes to changing Social Security, and I urge you to remind us in Congress that time is not on our side. We may jog, we may eat right, we may quit smoking, we may, if we're from California, do high colonics or any other sort of thing, but we will not get those years back. And we will suffer, particularly middle-income Americans who are saving a very small amount of their income. We will suffer the collective consequences. We must write our federal law so that working families, when they act to satisfy what is in their rational self-interest, discover the magic of compounding interest rates.

This example I have served up teaches us again that a penny saved can be worth a lot more than a penny earned. The personal investment plans that Senator Simpson and I are

offering create real savings from the first year an individual enters the work force, and provide years of compounding interest as a result.

Senator Lieberman of Connecticut and I have introduced legislation, called KidSaves, which builds on this idea. It says that if, in the midst of deficit reduction effort, we're going to give away tax credit for families with children, we should provide that in a refundable fashion, so that the families can set up individual retirement accounts for those children at an early age, so they can begin to take advantage of compounding interest even earlier. A tenth of a percentage point of our payroll tax could prefund \$1,000 per child at the moment of birth, and I believe that we could change the law and give Americans—137 million working Americans—a personal investment plan with no increases in taxes to get the job done. You could say to that family with \$30,000 a year in income, "You're going to have \$600 a year to save and it's going to accumulate." As a result, they would learn the magic of compounding, and they would put pressure on their lawmakers to change the law to allow them to begin to accumulate that wealth at an earlier age—at the earliest possible age, at birth, in fact—in order to be able to take advantage of the full power of compounding.

In addition to increasing potential return to investors, the increased investment in the economy may be as much as \$1 trillion in a single decade. Spread out over 137 million paychecks, it would help provide much needed capital for private investment. This increased savings will generate increased investment, which will generate increased wealth, which will make it easier for us once we've decided how much we want to provide in the way of a collective safety net, which will make it easier for us to be able to say that we can indeed afford the promise that we have made.

Wages cannot grow faster than productivity allows. Productivity growth would be greatly enhanced by increasing our national savings rate and by the resulting increase in investment. Finally, in addition to the direct impact upon savings, personal investment plans would serve to promote a sense of personal responsibility in American workers for their own financial future, and provide a sense of empowerment for those who take individual control of their retirement investments. And perhaps the worst argument that I have ever heard against this proposal is that American workers are too stupid to do this on their own. And I have heard more and more people walk to the podium after either I or Senator Simpson have spoken and say: "No, you can't do this. We have to have a mandatory collective tax that rips away the power to make individual decisions because Americans simply don't have the capacity, the intelligence, or the will to make these decisions on their own." I reject that argument.

Allowing Americans to Chart Their Own Course

Increasingly, Americans are saying not only do they have that capacity, but they want us to give them increased power to make those kinds of decisions. This objective of empowering Americans can't be overstated. If individuals who have a personal account take interest in their investments and are cognizant of growth in their wealth over time, they should start to break the yoke of economic anxiety over their future. This would be a big first step in helping to create the personal value of thrift in individuals and in the country.

The great demographic shift that will occur over the next 20 to 30 years will largely shape our economic future. The changes that are occurring need to be met with new assumptions, different rules, and a fresh perspective. When certain forces are overwhelming, change is inevitable. So it is with the demographic transformation of America.

The movement of the baby boom generation into retirement, coupled with increasing longevity and a shrinking working-age population, presages a new social equation. Our response to these changes will determine the financial well-being of our future elderly and the financial strength of our economy. Individuals of all ages are not prepared to meet the costs associated with living longer. Middle America's extreme lack of personal savings is evidence of this. America and Americans need to forge a new financial partnership, a cooperative venture among businesses, government, and individuals. The concept is not new; our system currently relies on all three.

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The issue is one of equitable allocation for the future. We all must take up the mantle of planning for our own financial needs. The most direct approach to reducing the financial liabilities of longer life is to save a portion of the cost over a longer period of life—beginning earlier in that life. Savings require setting aside a portion of current income to provide for future income—that is the basis for our personal investment plan.

The personal investment plan that Senator Simpson and I have put on the table is an essential ingredient to creating private wealth. Some have referred to it as partial privatization of Social Security, but I disagree. It is individualization of responsibility. It is providing the individual with the power and responsibility to create his or her own wealth. The plan

will promote increased self-reliance, boost economic growth, increase national savings, and help create the wealth necessary to ensure a strong economy for our children as they enter the 21st century.

Some will describe this proposal as intergenerational warfare. Not only is this wrong, it is also wrong-headed. The fiscal imbalance of entitlements versus discretionary spending threatens our implicit intergenerational compact to leave a prosperous and growing economy to the next generation of Americans.

The other day—in delivering a eulogy for William Colby, the former Director of the Central Intelligence Agency, who at the age of 21 volunteered to serve this nation and parachuted behind enemy lines in German-occupied France and again in German-occupied Norway—I said that this generation stands on the shoulders of the previous generations, giants who accomplished the miracle of defeating the worse tyrannies that this world has ever seen, giants who built the strongest economy and most powerful democracy. But not once when they made that sacrifice did they come to the edge, perhaps the end of their lives, and say, “What’s in it for me?” Not when they landed on the beaches on Normandy did they say, “I will only land on the beaches on Normandy if you provide me with some kind of payment when I return.” I did not serve my country with some expectation that my country would take care of me for the rest of my life.

I thank God that this nation is generous enough to provide disabled veterans, such as myself, with some kind of safety net. But the burden of responsibility and obligation is still on my side—to my nation—not the other way around.

This is not about bigger or smaller government. It is about something much more important. It is about allocation of resources, it is about a moral responsibility to the next generation, it is about deciding whether this generation wants to endow our children with a strong and vibrant economy as they enter the 21st century, and it is about taking action to put an end to today’s policies which stifle wealth creation and productivity. It is about doing what Scrooge did after the Ghost showed him the future: change our behavior now.

Chairman's Report

Jon S. Fossel

[Fossel is chairman of OppenheimerFunds, Inc., and also currently chairs the Board of Governors of the Investment Company Institute. Before joining OppenheimerFunds in 1987, Fossel was chairman and director of the distribution company for Alliance Capital Management Corp. Fossel received his BS from Tufts University.]

Fossel has been an outspoken proponent of improving the nation's low savings rate and helping Americans better prepare for their financial futures. In his speech before the membership of the Investment Company Institute, he underscores the importance of supporting federal government measures that will help Americans help themselves in preparing for retirement.]

Since our general membership meeting just a year ago, we have certainly experienced the sweet smell of continued success—success not only as measured by numbers but, more importantly, as measured by the trust and confidence of our shareholders. But let us never forget that trust is fragile: difficult to forge, easy to lose, and nearly impossible to rebuild. Let us never forget the importance of trust. Let trust be our guiding principle. Let us never take any actions to damage our compact of trust with our shareholders. Trust is undoubtedly easier to earn when we are doing well, but let us remember that it won't always be quite this good, it won't always be quite this easy. If we can retain today's trust when times are tougher, then we will have every right to be recognized as having achieved a great success.

More than 40 million Americans have entrusted us with the responsibility for a large part of achieving their hopes and dreams. They have worked hard for every dollar of the more than \$3 trillion they have entrusted to us. We must work even harder to keep earning their trust. Last year, I urged all of us to be advocates for positive change, and outlined six specific goals:

- First, to advocate open, honest, and understandable communication with our shareholders. With the leadership of SEC Chairman Arthur Levitt and his staff, tremendous progress has been made toward this goal with a simplified profile prospectus.
- Second, to find a better way to inform shareholders about risk and return. The preliminary recommendations resulting from the profile prospectus research are a significant step toward this goal.

- Third, to never overpromise and underperform. This becomes even more important as most markets keep hitting new record highs.
- Fourth, to keep our costs as low as possible while continuing to add high value. I am confident that the intense competition in our industry will serve to achieve this objective, but it will become even more important when investment returns are lower.
- Fifth, to fight for an SEC with adequate resources to help us identify and exorcise any improper industry practices. At this point, it appears that Congress will not cut the SEC's budget, which when combined with some internal reorganization, should ensure continued, thorough SEC oversight of our industry.
- Sixth, to always fight for our shareholders' interests with a special focus on reducing the tax burden on savings and an emphasis on enhancing the IRA. While there have been many proposals put forth on this issue by both Congress and the Administration, Americans today have no greater incentive to save than they did last year and the security of their retirement is in just as much jeopardy—if not more.

As I said last year, let us be our shareholders' loudest advocate when their voice is not heard. Let us put their interests before our interests but, at the same time, let us not be defensive about fighting for their interests when they coincide with our interests.

Today, let us broaden the narrow battle for enhancing the IRA, and lead the fight for improving our nation's savings rate and thereby helping to ensure a brighter future for millions of Americans whose futures are darkened by the cloud of woefully inadequate retirement incomes.

Theodore Roosevelt once said, "Far better it is to dare mighty things, to win glorious triumphs, even though checkered by failure, than to take rank with those spirits who neither enjoy much nor suffer much because they live in the gray twilight that knows not victory or defeat."

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Retirement Security

Let us make no mistake, when it comes to savings and retirement security, Americans are facing a crisis and cannot afford defeat. Health care, drugs, crime, education, and the environment are all important problems certainly, but none looms as large as the burgeoning savings/retirement crisis, and none will have as great an impact on the economic well-being of our country and the vast majority of our fellow Americans. It is in this arena that we must join Jack Kemp and Bob Kerrey and dare mighty things.

In fact, if we continue on the present path of inadequate savings and investment, we won't even begin to be able to deal with our other problems. America's growth will stagnate, our economic resources will plateau, and we will continue to be subject to the volatile behavior of foreign lenders and at an uncompetitive cost. Meanwhile, most Americans, especially our nation's 76 million baby boomers—the vast majority of whom will retire over the next 20 years—will face retirement with a drastically lower standard of living and a high likelihood of outliving their savings. The problems of tomorrow must be solved today. Tomorrow is too late.

Yet, for decades, government policies have discouraged savings and investment while encouraging spending and borrowing. How big a problem is it? Let's just look at two facts: 1) our savings rate is one half the savings rates of the world's seven other largest economies and less than one quarter that of the fastest growing emerging markets, and 2) our Social Security system has \$11 trillion in liabilities with only \$500 billion in assets. In slightly over 15 years, Social Security will be paying out more in benefits than it takes in taxes.

Unlike so many crises that are not easily foreseeable, the crisis of inadequate savings and a Social Security system that is badly broken is clearly identifiable. Moreover, the broad outlines of some solutions are equally clear.

As far as savings are concerned, it is crystal clear that, like most things, if you tax them less, there will be more of them. Right now, we tax nearly all income equally, whether we spend it or save it. In fact, we tax savings four times: once when we earn it as income;

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second, when we earn a return on it; third, when inflation eats into it; and fourth, when we pass it on in an estate. For those who say an enhanced IRA or capital gains tax reduction is only another tax break for the wealthy that doesn't increase their savings, I say "doubtful." But even if so, then impose reasonable income limits, and stop discriminating against men and women who choose to work in the home to raise their families. We cannot afford to save so little that we are unable to finance the growth of our great country, or to save so little that our elderly citizens are unable to retire in comfort.

While Social Security is only one element of providing for an adequate retirement, it has been the most certain element and, for most people of moderate and low incomes, the most important source of retirement security.

However, due to three major and highly predictable long-term trends, our Social Security system is at the point that it will not be able to meet the expectations of the vast majority of today's workers. Those three trends are the aging of America's 75 million baby boomers, the increasing life span of Americans, and declining birth rates.

These factors are beginning to cause Social Security to take on the worst characteristics of a giant Ponzi scheme, as some observers call it. The combination of fewer and fewer workers putting in and more and more retirees taking out is a looming financial train wreck. By 2013, more money will be taken out than is paid in, and by 2030, there will be nothing left. In other words, for every worker who today is 31 or younger, there will be nothing left when they retire.

The alternatives are clear:

- 1) Raise the payroll taxes to well above the current 12.4 percent. Some say they will need to be as high as 40 percent by the middle of the 21st century.
- 2) Reduce benefits meaningfully, probably by as much as 30 percent over the next 20 years.
- 3) Raise the return earned on the monies contributed.

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I would observe that raising Social Security taxes much further, when already three quarters of Americans pay more in Social Security taxes than federal income taxes, may be inviting the second “American Revolution” to spread well beyond Montana.

Furthermore, cutting benefits much further, whether by greater taxation of benefits, means testing, payout limitations, raising the retirement ages, or reducing COLAs, is nothing but a form of default on the implied contract that Social Security has with American workers. Without adopting significant positive changes at the same time, confidence in the system, and for that matter confidence in our political system, will only be further undermined.

This takes us to the third alternative, and several proposals made by many highly regarded groups, including members of the Administration’s Social Security Advisory Council. The essence of most of these proposals is that they retain the essential features of today’s Social Security system while raising some payroll taxes and reducing benefits somewhat, but at the same time allowing individual workers to put a portion of their taxes into an IRA-like “Personal Investment Account,” which should earn a far higher return than their payroll taxes will earn today.

Forecasters indicate that a median wage earner who is 50 today and retires at 65 will earn about a 1 percent real return in terms of benefits on the taxes that they and their employer pay. A 36-year-old worker can count on no return, a 21-year-old, a negative 1 percent, and a newborn, a negative 3 percent. For higher-income workers the numbers are worse, and for low-income workers the numbers are somewhat better, but in no event as good as they should be or need to be.

To look at it another way, a 25-year-old, low-income worker who retires under today’s system would receive more than twice as much per month in retirement if his or her payroll taxes had been invested in a balanced portfolio of stocks and bonds. For a middle-income worker, the difference would be even greater.

Mutual Funds as Investor Advocate

So the message is clear: we need to help America save for the future, to save for the future of our country, to save for the future of our working men and women, and to save for the future of our children.

What should we do about the problem? What role should the Investment Company Institute play? What role should each of us play? To quote Teddy Roosevelt again, “It is not

the critic who counts, not the one who points out how the strong man stumbled or how the doer of deeds might have done them better. The credit belongs to the person actually in the arena, whose face is marred with sweat and dust and blood. Who strives valiantly, who errs and comes short again and again, who knows the great enthusiasms, the great devotions, and spends himself in a worthy cause. Who, if he wins, knows the triumph of high achievement and if he fails, at least fails while daring greatly.”

So let’s all get in the arena and dare greatly. Let’s get in the arena on behalf of our 40 million shareholders, on behalf of all working Americans, on behalf of those already retired and those about to retire, on behalf of our children and the well-being of America. There is no better organization to strive valiantly for “Helping America Save for the Future” than ICI. We have the confidence of 40 million Americans—young and old, working and retired, well off and not so well off. We should not be afraid to have our faces “marred with sweat and dust and blood.” In fact, it is our obligation.

There will be some critics who will accuse us of favoring enhanced IRAs or capital gains tax reductions or personal investment accounts because they would be good for the mutual fund industry. They will say we have a vested interest. Well, if fighting for the futures of our shareholders—those hardworking American families who are finding it so hard to save enough for their children’s education or their own retirement—is a vested interest, then let’s ignore the critics and get in the arena. But let us always put our shareholders’ interest first. Let us fight for their interest. Let us continue to earn their trust. Let us spend ourselves in a worthy cause. Let us dare mighty things. Let us and our shareholders know the triumph of high achievement. Let us win glorious triumphs.

“We cannot afford to save so little that we are unable to finance the growth of our great country, or to save so little that our elderly citizens are unable to retire in comfort.”

—ICI Chairman Jon S. Fossel

President's Report **Matthew P. Fink**

[Fink is President of the Investment Company Institute. He joined the Institute in 1971 and served as General Counsel from 1977 to 1991. Fink is a graduate of Brown University and the Harvard University Law School. In a variety of forums, including Congressional testimony, Fink has consistently voiced the Institute's ardent support for proposals—legislative, regulatory, and otherwise—to educate investors and encourage long-term savings among Americans. In his speech before the Institute's membership, Fink stressed four main areas: educating Americans about saving; encouraging legislation that motivates saving and investing; ensuring that the fund regulatory system meets the needs of new generations of investors; and maintaining the fund industry's reputation for integrity.]

Since we met last May, our industry has had another successful year. Total mutual fund assets topped \$3 trillion in March. Mutual funds now serve more than 40 million individual shareholders and over one third of all U.S. households.

Our industry has been particularly successful at helping Americans save for retirement. Mutual funds are now the leading funding vehicle for many types of retirement plans, accounting for an estimated 38 percent of 401(k) assets, 40 percent of Individual Retirement Account assets, and 55 percent of Keogh plan assets.

Many wonder what the future holds in store. Prophecy is a risky business. Nevertheless, I am confident that, while there always will be ups and downs, our industry will continue to thrive.

Some argue that demographic and economic trends make our future success inevitable—the entry of the baby boom generation into their prime savings years; the steady growth of defined contribution plans; and the continued shift by households to investment in stocks, bonds, and pooled investments.

But I am skeptical that history is determined by iron laws of inevitability. I concur with Justice Frankfurter's observation that "there is no inevitability in history except as men make it."

My confidence in our industry's future is not based on a belief in inevitable trends. Rather, it is based on my conviction that the mutual fund industry will continue to thrive because we will continue to make the needs of individual investors our highest priority. Senator Kerrey and Jon Fossil have spoken of the personal savings crisis, particularly as it relates to retirement. Helping the average investor overcome this crisis is the most important task before our industry.

To do so requires action in four areas. First, we must educate Americans about saving and investment. Second, we must encourage legislation that motivates Americans to save and invest. Third, we must ensure the mutual fund regulatory system meets the needs of new generations of investors. Finally, and most importantly, we must ensure that our industry continues to earn its reputation for integrity.

Investor Education

If Americans are to do a better job of saving, they must understand their savings needs and their investment options. We can be proud that investor education has long been a priority for mutual fund organizations and the Institute. Our efforts have helped investors understand the importance of saving, and the risks and rewards of mutual funds. Moreover, education helps investors understand the importance of a long-term investment horizon. In fact, a recent Institute study found no evidence of shareholder runs on mutual funds in the 14 major stock market breaks of the past fifty years.

But our voluntary efforts are only part of the story. We must ensure that government policies encourage, not hamper, investor education. Without question, the most important step we can take is to improve the key mutual fund disclosure document, the prospectus.

Since August of last year, the mutual fund industry has tested a new disclosure document suggested by SEC Chairman Arthur Levitt—the profile prospectus. The profile provides investors with key information about a mutual fund in a clear, concise, standardized format. When the pilot program began, the Institute and participating members committed to the Commission to conduct extensive research on investor reaction. Our research results were submitted to the Commission just yesterday [May 20, 1996]. Survey respondents gave the profile significantly higher marks than the traditional prospectus, and two thirds supported use of the profile as an offering document.

Based on these results and our experience with the profile, we believe that the time is ripe for further Commission action. Our submission suggests that the Commission consider

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seeking public comment on proposed rules that would authorize funds to distribute the profile to investors with an application that investors may use, at their option, either to purchase fund shares or to order the traditional prospectus.

Later today, the Institute along with the eight fund complexes that took part in the pilot, will hold a press briefing to discuss our submission. But there are two points that I would like to emphasize right now.

First, the profile is not just a shortened version of the traditional prospectus. It is a completely new disclosure document that zeroes in on the essential information that an investor needs. Thus, the profile provides information that you will not find in the traditional prospectus—like a ten-year total return bar chart.

Second, the Institute's submission suggests a number of ways to improve the test model approved by the Commission last year. These include, for example, a comparison of the fund's return with one or more indices, and more information about a fund's portfolio manager.

I am hopeful that our submission will be of assistance as the Commission contemplates further action. We look forward to a Commission rule proposal that would solicit the views of others and further the public debate on this important initiative. Chairman Levitt's leadership in this effort demonstrates his strong commitment to consumers.

With strong support from the Institute, the Department of Labor also is taking a more active role with respect to investor education. Among other initiatives, the Department has proposed an interpretation that encourages employers and service providers, including mutual funds, to furnish employees in defined contribution plans with a wide variety of education information.

As we seek ways to better inform investors, we must recognize when information can confuse, rather than enlighten. Use of quantitative risk measurements such as beta and standard deviation—as well as commercial products like “market risk” ratings for bond funds—are a case in point. A recent Institute survey of shareholder assessment of risk disclosure methods found that there is no magic bullet, no single measure that can account for or predict all aspects of a fund's risk. We must oppose the use of risk measures that would mislead investors into thinking otherwise.

Savings Legislation

Second, we must encourage legislation that motivates Americans to save. As Senator Kerrey and Jon Fossil have noted, government policy is a critical factor in personal saving. In an ideal world, Americans would not need incentives to save. But we live in the real world, where personal savings are directly tied to incentives, particularly tax incentives.

Just consider the history of Individual Retirement Accounts. In 1982, when IRAs were made available to all workers, IRA contributions amounted to \$28 billion, and by 1986 had increased to \$38 billion. In 1986, however, Congress cut back sharply on IRA deductibility. In 1987, IRA contributions fell over 60 percent, to \$15 billion.

The Institute assisted in the creation of IRAs in 1974. We took a leading role in IRA expansion in 1981, and in opposing cutbacks in 1986. We will continue to urge Congress to expand IRA eligibility.

The Institute also supports legislation that would encourage small companies to provide retirement plans for their employees. In 1993, only 29 percent of employees who worked for small companies were covered by retirement plans, as compared to 83 percent in larger companies.

Both Congress and President Clinton support legislation to expand IRAs and to increase small plan coverage. We are hopeful that this legislation will be enacted into law. The Institute also is committed to furthering debate on retirement security, particularly as it pertains to Social Security reform. It is critical that policymakers restore public confidence in the Social Security system. This past year, the Institute testified on the Simpson/Kerrey bill, which would allow employees to invest roughly one third of their Social Security payroll taxes in individual accounts. Senator Kerrey deserves much credit for his leadership.

In short, in a variety of areas—IRAs, employer plans, and Social Security, our industry must continue to support legislation designed to encourage personal savings and investment.

Fund Regulation

Third, we must ensure that the mutual fund regulatory system is kept up to date to accommodate the changing needs of investors.

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*—ICI President
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The Investment Company Act is an unusually effective statute. The act's core provisions—the requirement that every fund mark its assets to market every day; flat prohibitions against transactions between a fund and its managers; strict limits on leveraging; and a statutory system of independent directors—are unique to our industry. They have enabled us to avoid the crises that have repeatedly wracked other types of pooled investment media—from real estate investment trusts in the early 1970s, to the Orange Country municipal fund in the early 1990s.

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The 1940 Act also provides the SEC with broad administrative authority to adjust requirements to meet new conditions. And the SEC has used this authority wisely.

But only Congress can address the major regulatory problem burdening our shareholders and our industry—the inconsistent crazy quilt of state mutual fund regulation.

This system of idiosyncratic state regulation is contrary to the interests of investors. It needlessly duplicates, and often undermines, SEC initiatives to improve investor protection. It helps produce prospectuses that are lengthy, complex, and difficult to comprehend. It hinders innovations in fund products and services permitted by federal law. It imposes undue compliance burdens on funds. And it diverts state resources from enforcement and education, where state action is required.

Justice Brandeis once observed: “It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory, and try novel social and economic experiments without risk to the rest of the country.”

Applying the Brandeis test, the experiment of permitting states to regulate mutual funds has clearly failed. States exercise their regulatory authority in a manner inconsistent both with federal law and with each other. Moreover, it is virtually impossible to confine the impact of a state's activities to its citizens. Portfolio limitations and disclosure requirements imposed on a fund by a single state affect all of the fund's shareholders nationwide. Continuing the “experiment” is, in Justice Brandeis' terms, fraught with “risk to the rest of the country.”

Countless efforts to address this problem at the state level have failed. This national problem requires a national solution.

I am pleased to note that last Wednesday, the House Commerce Committee unanimously approved legislation under which standards governing fund portfolios, prospectuses, and advertisements would be set exclusively at the federal level, with the states retaining authority to assess fees, receive filings, and bring enforcement actions. This solution was proposed by Chairman Levitt last October, and is supported by members of both parties, by the mutual fund industry and, I believe, by many state officials. We are hopeful that a bill will be introduced in the Senate as early as this week and that Senate hearings will be held in June. If I were to name one governmental action that would be of the greatest benefit, it would be enactment of this legislation.

Thus far, I have discussed three keys to our future success—consumer education, incentives for savings, and effective, pro-consumer regulation. But the fourth ingredient is the most important of all—maintaining the integrity of the mutual fund industry.

Industry Integrity

We can be proud of our reputation. As noted in a recent editorial in *Mutual Funds Magazine*, “the American mutual fund industry has a record of integrity and fair dealing with investors that is the envy of the world.”

This is not by luck. We have always sought strong and effective government regulation. Moreover, in many cases, the mutual fund industry has voluntarily adopted standards that exceed both regulatory requirements and the rules that govern our competitors. The restrictions on personal investing that the fund industry embraced in 1994 come to mind. No other type of pooled investment is subject to comparable standards, and we adopted them voluntarily.

New entrants to our industry and outside observers often remark how unusual it is for an industry to call for strong regulation by government, and for even higher voluntary standards. But these are hallmarks of our industry, and keys to our success.

This past year has been no exception. We strongly supported the SEC as it sought ways to improve mutual fund disclosure of risk, tighten portfolio standards for tax-exempt

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money funds, and improve SEC inspections. We also supported the NASD as it increased its oversight of sales practices.

We sponsor a wide range of conferences, seminars, and training courses to educate fund personnel. We have helped mutual fund groups meet the NASD's continuing education requirements. We expanded our programs for fund directors. We even moved beyond education for fund employees and directors by working with the National Endowment for Financial Education to develop a mutual fund training program for sales personnel.

We must always remember that the best way to maintain the confidence of our shareholders is to subject ourselves to the most rigorous regulatory, professional, and ethical standards.

In conclusion, please allow me a personal note. This is my fifth annual address to you as president of the Institute. During these five years, I have been impressed by many things: the volume and complexity of the issues facing us; the dedication of the Institute's outstanding staff; and the wise counsel I have received from three Institute Chairmen—Jim Riepe, Ron Lynch, and Jon Fossil. But most of all, I have been impressed by so many of you in the industry, who put aside individual interests to work for the common good of mutual fund shareholders. Our industry's success is the result of this willingness to put our shareholders' interests first.

We supported enactment of the pro-consumer Investment Company Act nearly six decades ago, and ever since we have supported strong SEC regulation in the interest of investors. Over the years, we have backed statutory and regulatory modernizations that have permitted fund organizations to develop new products and services to meet the changing needs of investors. We have worked for enactment of laws encouraging personal savings and investment—the 1962 Tax Act, which gave birth to Keogh plans; ERISA, which created IRAs and gave a major boost to defined-contribution plans; and the Economic Recovery Act of 1981, which made IRAs available to all workers. And when crises have arisen, we have addressed them decisively in the interest of our shareholders, as in the case of personal investing by fund personnel.

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Our success cannot be attributed to fortuitous trends, or to blind luck. Rather, our success stems from deliberate actions that we have taken, in the marketplace and in Washington. The mutual fund industry is proof of the observation of that great baseball executive Branch Rickey, who noted that “Things worthwhile generally just don’t happen Luck is the residue of design.”

Senator Kerrey and Jon Fossil have laid out in stark terms the magnitude of our nation’s personal savings crisis. Deliberate action, not luck, will lead the nation out of this crisis. I am confident that the mutual fund industry will rise to the challenge, for the sake of our shareholders and for all American investors.

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- Vol. 1, No. 2, November 1995: ***“Improving Mutual Fund Risk Disclosure”***
- Vol. 2, No. 1, January 1996: ***“Mutual Fund Regulation: Forging a New Federal and State Partnership”***
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