Remarks By
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Check Against Delivery

Thank you, and good morning. Your industry has played a unique role in perhaps the most significant recent development in our markets: the rise to prominence of the individual investor. But you have a great responsibility, as well.

Today I'm going to discuss with you whether you've done enough to educate the individual investors who are pouring into your funds. I'm going to ask whether you're adequately communicating with them so they understand risk and returns. And I'm going to challenge your directors to be bolder and more courageous in representing those individual investors.

The time to take stock is now. Every day, more and more Americans are participating in the markets -- to finance their children's education, their retirements, all of their American dreams. The mutual fund is the investment vehicle of choice for millions of investors. And there's every indication that this trend will continue.

The press is full of reports about the possible privatization of Social Security. That makes this a timely moment for us to stop and ask: Are you -- the fund industry -- ready for the new investors -- many of them first-time investors -- who are pouring their retirement assets into the markets? Even without the privatization of Social Security, your business is booming. Funds hold a staggering amount -- nearly $5 trillion in assets, up from just over $1 trillion in 1990.

In the great bull market of the 90s, you've made millions of people very happy. A recent survey of small investors showed that 95 percent of Americans are satisfied with the returns on their funds -- the highest score ever obtained by any product. In the words of one columnist, "Mutual funds now are officially the best product ever." They're "the ultimate consumer dream product." These statistics are marvelous -- but they are also scary, because they can lead to complacency.

The financial literacy of Americans has not kept pace with the growth of fund investments or investor satisfaction. Three-quarters of all workers have no idea of how much they need to save for retirement. They also have totally unrealistic expectations about how their money will grow. A recent survey found that mutual fund investors anticipate returns of more than 20 percent a year for the next decade. That's dangerous.

Our own research shows that less than half of these people know that fund expenses are deducted on an ongoing basis. Only 8 percent say they completely understand the expenses that their funds charge. We can only guess whether they actually do. Financial illiteracy is very troubling in an era when workers are shouldering a significant portion of their retirement planning through 401(k) plans and IRAs.

And financial illiteracy is downright frightening when you imagine a privatized Social Security system, in which workers' basic economic well-being could depend totally upon their own investment savvy. The time to focus on this problem is now -- while the sun is still shining, the market still rising. I'm pleased that, together, we've taken significant first steps to close the gap between the knowledge investors have and the knowledge they need.

The Commission and the ICI, with a coalition of other government agencies, businesses, and consumer organizations, recently completed the highly successful kick-off of the national "Facts on Saving and Investing Campaign." That's a start. But that campaign is not the only good effort taking place. A quick look at funds' web sites convinced me that many individual fund groups are joining in the investor education effort.

American Century, Dreyfus, Fidelity, Franklin-Templeton, Merrill Lynch, Scudder, T. Rowe Price, Vanguard -- to name just a few -- provide educational materials on their web sites. They offer retirement planning worksheets, discussions of risk, and even investor quizzes. I'm also pleased by the efforts of fund groups like Stein Roe and Neuberger & Berman to reach out to younger investors.

These are encouraging signs. But we cannot stop with these efforts. Ask yourselves whether you have done enough to educate investors about how to safeguard their financial future. Are American workers really ready to manage their own Social Security accounts? It's not enough to educate investors generally about investment concepts. They need specific, understandable information about the 6,000 available funds.

We at the SEC have created the framework on which you can build better, clearer, more useful communications. We did a top-to-bottom overhaul of the mutual fund prospectus to focus on essential information. We created the profile to respond to investors' desire for more choice in the format and amount of information they receive about funds. And we asked you to translate your prospectuses into plain English. A number of funds have heeded our call for better communication.

But now it's time for the whole industry to carry out the promise of our efforts. The industry must speak with a new voice that reaches the millions of fund investors whose retirement nest eggs depend on them making sensible choices today. The time for piecemeal and haphazard experiments is over. We're chagrined to hear that some of you intend to make only a few cosmetic changes and mostly leave your prospectuses as they are -- the same dense, legalistic presentations that investors don't want, don't understand and don't read.

In our book, that merits a failing grade. We are not looking for a little bit of window dressing on the same old recycled gobbledygook. We expect you to do whatever it takes to speak to investors in a language they can understand -- English. You're proud to tell the newspapers about your funds. You tell the broker-dealers. You tell Morningstar. You tell Lipper. Now you need to tell your shareholders -- clearly and unequivocally.

I want you to look beyond your prospectuses when you think about how you communicate with investors. I do, and I worry that the fund industry is building unrealistic expectations through performance hype. I read the ads. I see nothing but performance, performance, performance. Why not outline clearly the impact of expenses or the nature of risks?

We all know that investors pour money into funds that are short-term top performers. We also know that stellar recent performance is no predictor of solid results in the long run. I think you do a real disservice to investors when you encourage them to chase short-term goals. You also jeopardize the fund industry's future when you just sell performance. The average equity fund was up more than 24 percent in 1997 -- and almost 12 percent in the first quarter of this year alone. Those numbers contrast sharply with long-term market returns of about 10 to 11 percent a year.

You're setting yourself up for millions of disappointed investors when your selling efforts focus exclusively on the recent bull market. You're setting yourself up for trouble down the road when you ignore risks and expenses. Where are the pioneers among you who are willing to stand apart from the rest? Consider expenses. Do you really expect investors to understand the alphabet soup of A, B, C, D, I, Y, and Z shares? To figure out what combination of front-end loads, CDSLs, 12b-1 charges, commissions, and who knows what else they're paying?

You've got to do a better job of making sure that those who sell funds also explain the costs of investing. I'm disturbed at the number of investors who don't understand the impact of fees and expenses. I don't have to tell this audience -- a 1 percent fee will reduce an ending account balance by 17 percent on an investment held for 20 years.

I've never believed the Commission should tell funds how much to charge or how to charge it. But I'm very concerned that investors are ignorant about expenses and fees. And consider risks. Only last week, we settled a case -- involving a bank -- where older people who owned CDs were sold interests in risky term trusts -- leveraged, closed-end funds that held high-octane derivatives. They were sold by an institution associated with safety and soundness -- in a way that led many investors to believe they were buying insured bank products.

It's easy to sell in prosperous times. But suitability must be your watchword at all times. Ask yourselves whether brokers' incentives are aligned with the customer's tolerance for risk. If not, do something about it -- now. I read in the paper the other day about a very satisfied mutual fund customer. Thirteen-year-old Candice Farr said the best use of her money is to put it in a mutual fund.

"I've made $2,000 profit in a year," she said. "I didn't think you could make that much." It's your job to make sure that Candice understands risk, so she won't be surprised if she sees a $4,000 loss next year. Otherwise, satisfied 13-year-old Candice could become disillusioned 15-year-old Candice -- finished with mutual funds before she's old enough to drive, or old enough to vote.

Education and communication -- those are two of the areas where I want to challenge you to think about how best to respond to investors' needs. A third critical area is fund oversight. Everyone knows that the fund director is the shareholder's representative. But the proper role of a fund's board has become a bit controversial lately. Questions have been raised at the Commission and in the courts.

For example: When is a director independent? How active should the board be in carrying out its responsibilities? What are the respective roles of the board and the shareholders in selecting and terminating the fund's adviser? Debate is a good sign. Important issues of fund governance are getting the attention they deserve.

For some time, I've wanted to bring together all the parties interested in fund governance -- to air the issues and to work toward a consensus on whether changes are needed in the current system. And so, the Commission will be hosting a roundtable on fund governance this fall. We will bring together investor advocates, directors, fund managers, academics, and others for what we hope will be a lively exchange of ideas.

Board independence does not come from a particular legal structure. It comes from individual directors -- like yours -- doing their jobs aggressively.

Directors -- like yours -- who take their jobs seriously.

Directors -- like yours -- who act as fiduciaries.

Directors -- like yours -- who have the confidence to question the fund's manager.

You know what has to be done. You know what has to be asked:

Which broker is being used? Why that one and not another? What is the value of the services provided? And -- are the computer systems adequate for the year 2000 problem? Has the adviser made sure that the fund's service providers are Y2K compliant?

Fees have to be questioned. Directors don't have to guarantee that a fund pays the lowest rates. But they do have to make sure that fees fall within a reasonable band.

There are some who say fund directors need not be as strong as corporate directors -- that their role is different. That it requires less effort, less independence or less vigilance. Those who buy into this myth are making excuses for directors who don't have the time or the interest to stand up for shareholders.

And I will only caution you to be careful. Funds whose directors forget whom they represent won't be long for the business. I don't expect fund directors to run day-to-day operations. But I do expect them to remember whom they serve -- fund shareholders. And I expect fund directors to be tireless in the pursuit of shareholder interests.

It's great to see our economy booming and our investors thriving. Our capital markets enjoy a level of investor confidence that is truly the envy of the world. Today, we're seeing nothing but clear skies. But we cannot rest easy, imagining that financial clouds will never reappear. The time to fix the roof is while the sun is shining -- and the time to take stock of our efforts is now. We'll be ready to weather any storm -- if we redouble our efforts at investor education, and if we help teach investors to match their short-term decisions with their long-term needs.

Today, I've asked you to reflect on whether you've done enough to educate investors. I've asked you to consider whether you've planned wisely enough to prepare for a possible bear market. And I've asked you to consider whether your directors are doing a good enough job of governing your funds with integrity. You're part of a great tradition that has helped strengthen our nation and sustain our growth.

You've raised more than capital. You've raised our nation's standard of living -- and you've lifted our vision for the future. But in the modern-day economy, you've gained a crucial new role -- and a critical new responsibility. Think of the millions of families who have sent their life savings to you. Think of the investors, large and small, who have shown confidence in your judgment. Think of the rising tide of satisfied investors, who are relying on you to continue fulfilling their dreams.

Are you keeping faith with them? Are you living up to the great tradition of the American marketplace? The tradition of openness . . . of candor . . . of transparency . . . of trustworthiness? Are you honoring the enormous amount of confidence that the investing public has placed in you? They have entrusted you with their dollars . They have entrusted you with their dreams. They have entrusted you with their destinies.

By being responsive to their needs -- and by being resourceful with your plans -- I'm confident that you'll justify their great faith in you.

Thank you very much.

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